PepsiCo, Inc., Annual Report 1977

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PepsiCo, Inc.:

PepsiCo's efforts, in all its activities, are predicated on the fulfillment of three fundamental objectives:

- to earn the highest possible return on its shareholders' investment consistent with fair and honest business practices;
- to insure steadily increasing per-share profits and dividends paid to shareholders;
- to perform consistently better than the industry in every market where PepsiCo products and services compete.

To accomplish these objectives, PepsiCo's ten separate operating divisions are involved in five major business segments: beverages, food products, food service, transportation and sporting goods. Each operating division is responsible for developing its goals, strategies and programs consistent with its external environment and PepsiCo's overall corporate objectives.

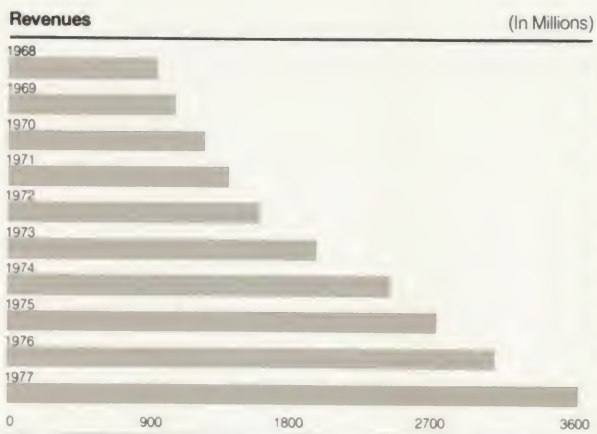
Within this organizational context, PepsiCo's senior management is responsible for determining the basic strategy necessary for the achievement of the corporation's fundamental goals. They must also make certain that each operating division itself develops strategies which are compatible with, and supportive of, corporate objectives and that each is staffed with people who have the depth of ability and experience necessary to see that its programs are successfully implemented.

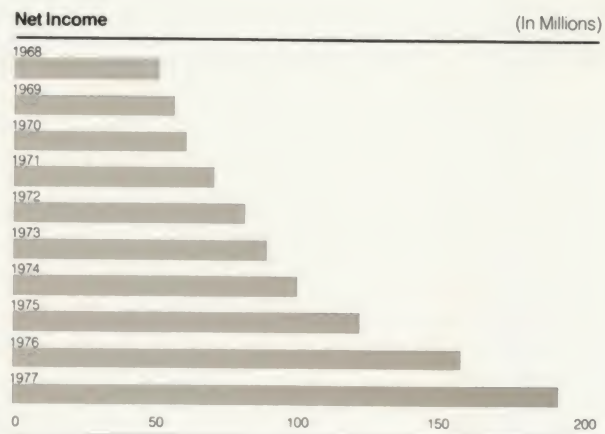
The pages of this report document how PepsiCo, again in 1977, successfully met the challenges inherent in the goals it has established for itself, and how it is working to sustain its performance in 1978 and beyond. The report also graphically portrays the pervasiveness of PepsiCo products and services and the pleasant associations they have for the hundreds of millions of consumers who know and respect them for their uncompromising standards of quality.

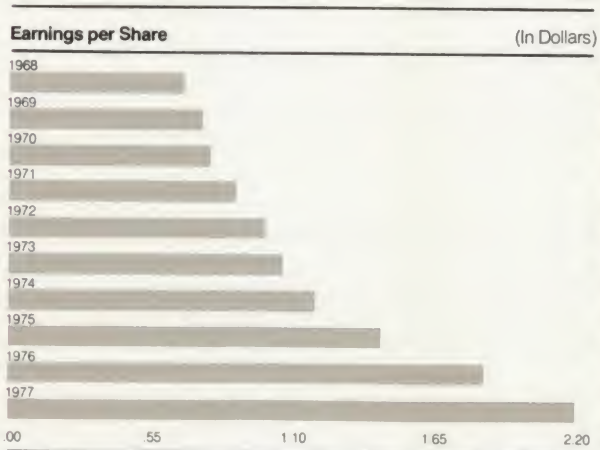
Financial Highlights

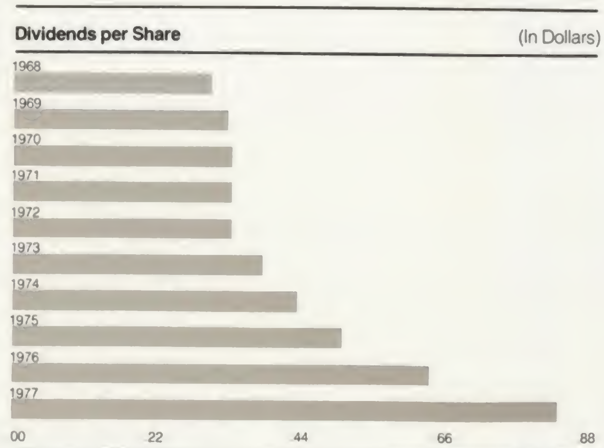
	1977	1976	Change
Revenues	**$3,545,714,000**	$3,030,612,000	+17%
Net income	**$187,339,000**	$153,848,000	+22%
Net income per share	**$2.15**	$1.80	+19%
Average shares outstanding	**87,109,000**	85,671,000	—
Dividends	**$66,287,000**	$47,258,000	+40%
Plant and equipment expenditures*	**$240,691,000**	$157,513,000	+53%
Long-term debt	**$311,709,000**	$298,153,000	+ 5%
Capital lease obligations	**$116,141,000**	$103,524,000	+12%
Shareholders' equity	**$971,847,000**	$845,823,000	+15%

*Excludes capital leases.









To Our Shareholders:

The year 1977 was another exceptionally good one for PepsiCo. Since its founding in 1965 through the merger of Pepsi-Cola Company and Frito-Lay, Inc., PepsiCo has consistently increased its sales and profits each year. In the last three, earnings growth has exceeded 20 percent annually, outstripping the impressive average of the preceding decade.

For 1977, PepsiCo's net income rose 22 percent over 1976 to $187.3 million on total revenues of $3.55 billion, 17 percent above the year-earlier figure. Earnings per share increased 19 percent to $2.15 from a restated $1.80 in 1976. All of these figures include the full year results of Pizza Hut, Inc., acquired in November 1977. Prior year figures have been adjusted to account for this acquisition on a pooling-of-interests basis.

Based on these results, the PepsiCo Board of Directors voted two dividend increases totalling 35 percent in 1977. At their current rate of 90¢ per share, dividends are now 170 percent above what they were in 1972.

PepsiCo's exceptional performance in 1977 resulted from strong increases in sales and operating profits achieved in all our lines of business except sporting goods. Sluggish sales, oversupply, extensive discounting in a more slowly growing sporting goods market, and substantial investment spending undertaken by Wilson during the year caused that company's profits to decline. An improving sales trend in the second half, however, indicates that Wilson is well on the road to recovery.

The major contributors to the corporation's 1977 success were PepsiCo's core soft-drink and snack-food operations, with strong sales and profit increases—as well as gains in the shares of their respective markets. In both, volume growth for the year far exceeded the averages for their industries. The transportation business also had one of its best years, and our newly added fifth line of business—food service, represented by Pizza Hut—continued its trend of strong growth in revenues and profits.

Again in 1977, PepsiCo has continued to stress improvement in its profit margins and cost control with encouraging results. The corporation's return on revenues advanced to 5.3 percent, compared to 5.1 percent in 1976, its highest level in 8 years. Return on shareholders' equity, at 19.3 percent, set a new record, more than a point above the high level reached the previous year.

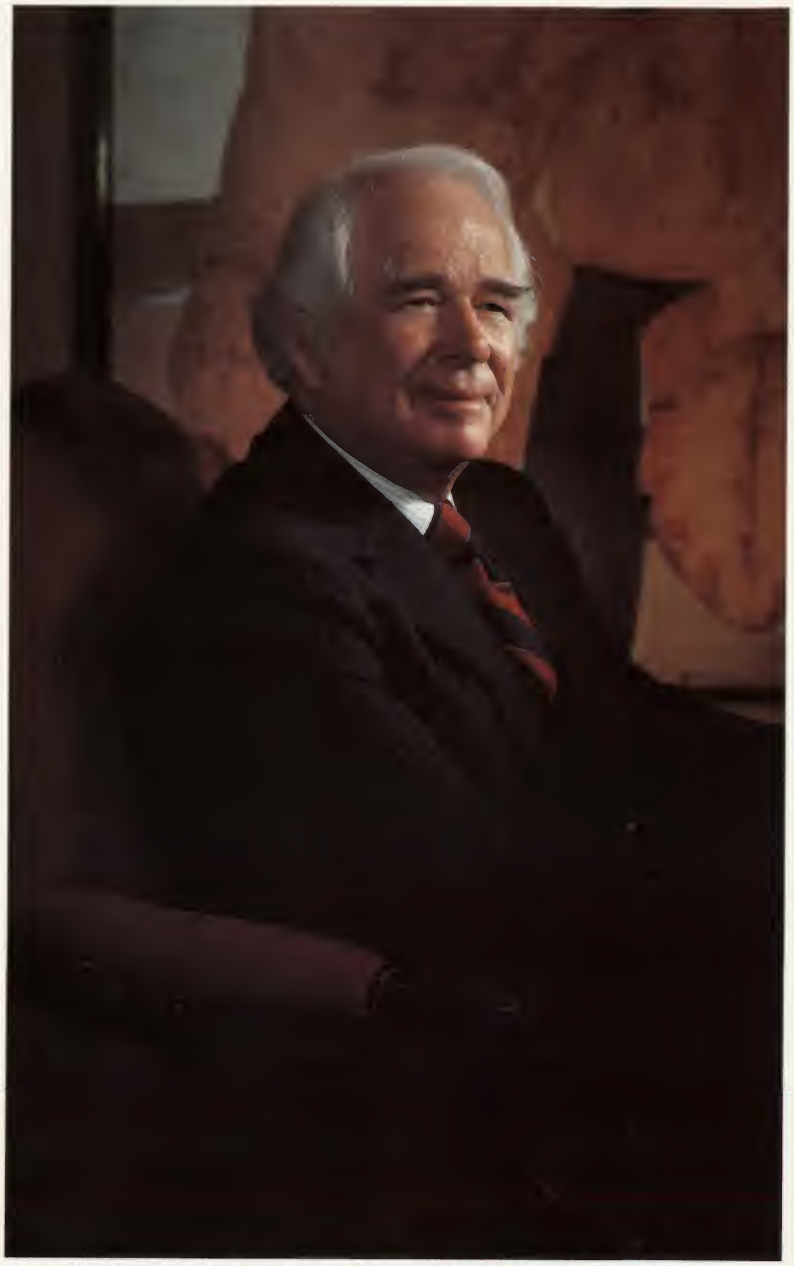
The strong volume growth of PepsiCo's businesses—particularly in soft drinks and snack foods—led to an upsurge in our 1977 capital investment. Plant and equipment expenditures (excluding capital leases) rose substantially to a record level of $175 million ($241 million in total when Pizza Hut is included.) To keep pace with the rising demand for our products and services, we plan further increases in capital expenditures in 1978 to approximately $325 million. Our exceptional earnings growth and our favorable cash flow have enabled us to fund virtually all of these investments internally, and we expect to continue to do so in the current year.

These same factors have strengthened PepsiCo's already sound financial condition, prompting the two principal credit rating services to raise PepsiCo's bond rating. We have also continued our trend of improving balance sheet ratios. The key total debt to total capitalization ratio dropped from 28.7 percent to 26.5 percent before capitalization of leases, and from 34.8 percent to 32.8 percent on the new basis including such leases.

A major event of last year was the acquisition of Pizza Hut, Inc. which has an excellent record as a fast-growing, highly profitable and well-managed business. This Wichita-based company, which presently has over 1,650 company-operated Pizza Hut restaurants and 1,550 franchised outlets, approached PepsiCo early in 1977. It attracted our interest when we learned it was seeking a partner with the kind of resources PepsiCo could provide: an economical source of capital to sustain Pizza Hut's carefully planned growth, extensive marketing experience and a solid base of expertise in the international field.

We are delighted to have this fine organization on our team and anticipate that it will prove itself an important contributor to PepsiCo's continuing success. Mr. Frank L. Carney continues as Pizza Hut Chairman and President and we welcome him as a member of the PepsiCo Board of Directors.

In February 1978, PepsiCo announced it had reached an agreement to acquire the Taco Bell chain of Mexican-



Donald M. Kendall, Chairman of the Board and Chief Executive Officer

Andrall E. Pearson, President

Photos by: Karsh of Ottawa

food restaurants. The acquisition, which will substantially expand the corporation's food service operations, is proceeding on schedule and is expected to be completed in June of this year.

Since the beginning of this decade, PepsiCo has experienced dramatic growth and expansion which has taken it from a company of just over $1 billion in sales to one which should achieve revenues approaching $4 billion in 1978. Underlying this record of achievement, and placing the corporation in a position for future growth, is the consistent application of business strategies which have proven themselves effective. First is our planned diversification in order to enhance growth and, at the same time, to insure stability.

Second is the commitment to heavy reinvestment in our businesses. Perhaps the strongest operating characteristic of 1977 was PepsiCo's heavy investment in the basics of each of our operations through capital expenditures and support of sales and marketing efforts. PepsiCo's growth over the years has never been achieved at the expense of the future.

Third, the corporation's management philosophy focuses on setting high goals and rewarding individual and group performance based on the degree to which they achieve or surpass those objectives. We believe that individual creativity and initiative will best serve the corporation's ends if allowed to flourish in an environment which is no more structured than necessary. Within appropriate limits, therefore, managers are given wide latitude in working toward corporate objectives.

Fourth, PepsiCo is an international company which looks upon the entire world

as a potential market for its products. Our soft drinks are presently available in some 140 countries and territories outside the United States. We are at earlier stages of overseas development in our other businesses, and this presents tremendous potential for future growth on a planned and disciplined basis.

Fifth is the corporation's commitment to continuing gains in share of market for each of its products and services. This requires a strong emphasis on research and development in order to define consumer needs and to design products and services to fulfill them. Succeeding pages of this report detail some of the many product and service innovations introduced last year and planned for the future. As part of this effort, ground was broken in November for a new PepsiCo Technical Center in Mount Pleasant, New York. The Center will provide the facilities and working environment which will allow our scientists to conduct a broad range of beverage-related research and to carry out quality control procedures, testing, development and engineering functions.

During 1977, James M. Roche, former Chairman and Chief Executive Officer of General Motors Corporation, retired from PepsiCo's Board of Directors because he had reached the mandatory retirement age. A conscientious, dedicated and hard-working director, Mr. Roche brought to PepsiCo a combination of experience and ability which will be hard to duplicate. We very much miss his wise and informed counsel and express our most sincere gratitude to him for all his efforts on behalf of PepsiCo.

William L. Lindholm retired as a PepsiCo Director on March 31 of last year, the same day he retired as President of American Telephone and Telegraph Company. We appreciate the service he rendered the corporation and wish him a happy retirement.

William T. Coleman, Jr., formerly U.S. Secretary of Transportation and currently a partner in the law firm of O'Melveny & Myers, was elected to the Board in January of 1977. With his many years of government service and the depth of his experience in other fields, PepsiCo is indeed fortunate to have the benefit of his services.

At its January 1978 meeting, the Board elected to membership Dr. Arnold R. Weber, Provost of Carnegie-Mellon University and a nationally known labor economist. He has held a number of important positions in agencies of the Federal Government including the U.S. Department of Labor and the Office of Management and Budget. He was also the first Director of the Cost of Living Council. We welcome him as a Director and look forward to his active participation on the Board.

Also during 1977, we implemented a number of top management promotions reflecting the changing needs of a company more than three times larger than at the beginning of the decade. Victor A. Bonomo was promoted to the new corporate post of Executive Vice President, Operations. Appointed to succeed him as President of Pepsi-Cola Company was John Sculley. John J. Kickham, in turn, replaced Mr. Sculley as President of PepsiCo Foods International, and was succeeded as northAmerican Van Lines President by Kenneth W. Maxfield.

In addition, because he has reached the mandatory retirement age, Harold R. Lilley retired as Chairman of the Board and Chief Executive Officer of Frito-Lay and as PepsiCo Vice President, Food Operations (U.S.) effective December 31, 1977, after 31 years in the snack-food business. He will also retire as a PepsiCo Director in May of this year. Both as an operating executive and as a Director, Mr. Lilley has been a great asset to PepsiCo, and he will be sorely missed. D. Wayne Calloway has been elected Vice President, Snack Foods (U.S.) and assumes control of Frito-Lay as its President and Chief Executive Officer.

In February, Norman Heller was appointed as President of PepsiCo's restructured Wines and Spirits International Division.

For 1978, we do not realistically expect to sustain the extraordinarily high earnings increases generated in the past three years. However, the positive momentum developed in this period, and the early reports already received this year from the field, suggest that our performance in 1978 should more than meet traditional company earnings targets. In any event, PepsiCo has the resources, experience and depth of employee commitment to confront the challenges and to capitalize on the opportunities which lie ahead.

We would like to thank PepsiCo's employees for their initiative, ingenuity, dedication and hard work in 1977. We also extend our appreciation to all PepsiCo shareholders for their continuing confidence in the corporation.

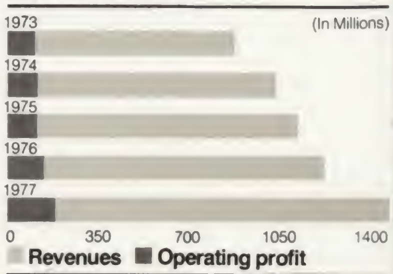
Donald M. Kendall

Donald M. Kendall
Chairman of the Board and Chief Executive Officer

Andrall E. Pearson

Andrall E. Pearson
President

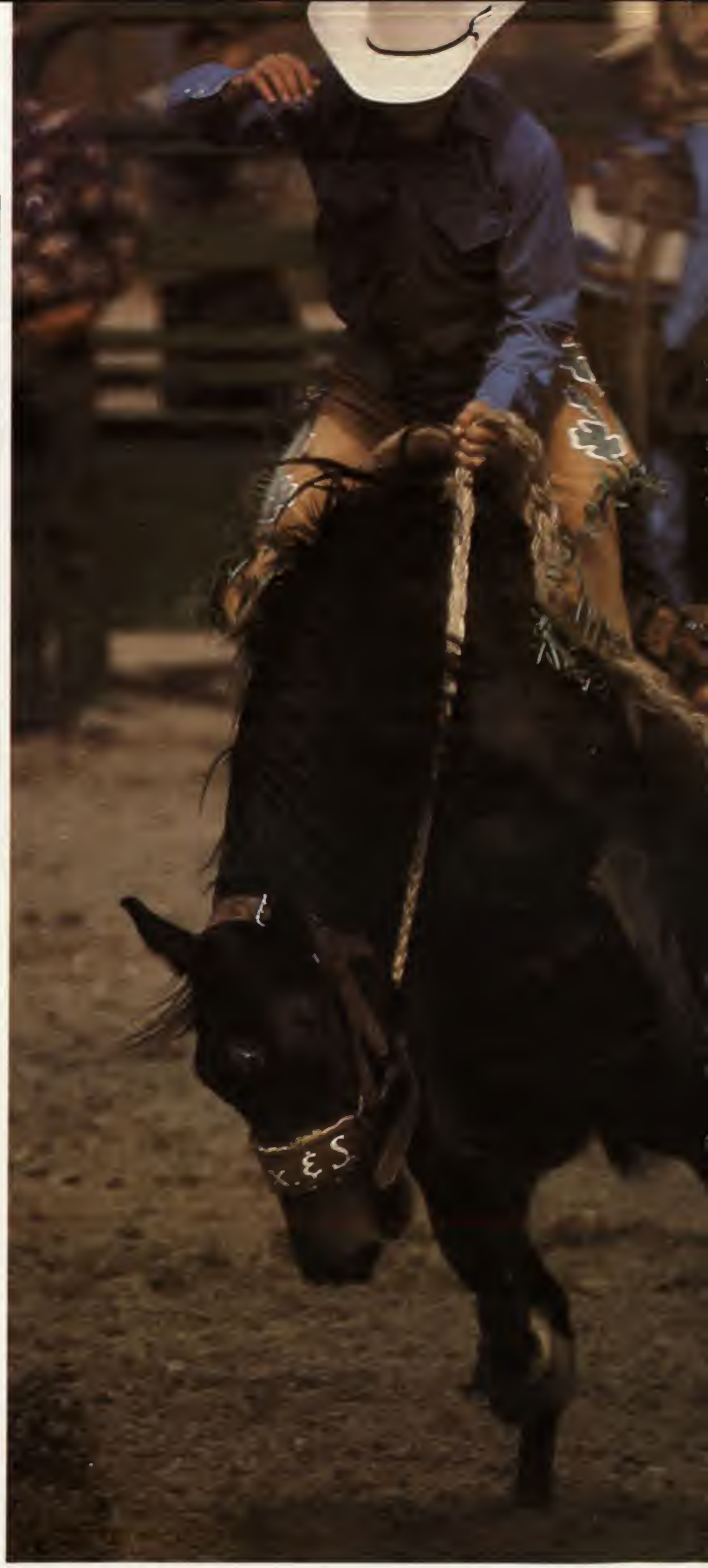
BEVERAGES



Soft Drinks: Soft drinks comprise the largest segment of PepsiCo's total business, and the performance achieved by Pepsi-Cola Company in 1977 was the best in its history.

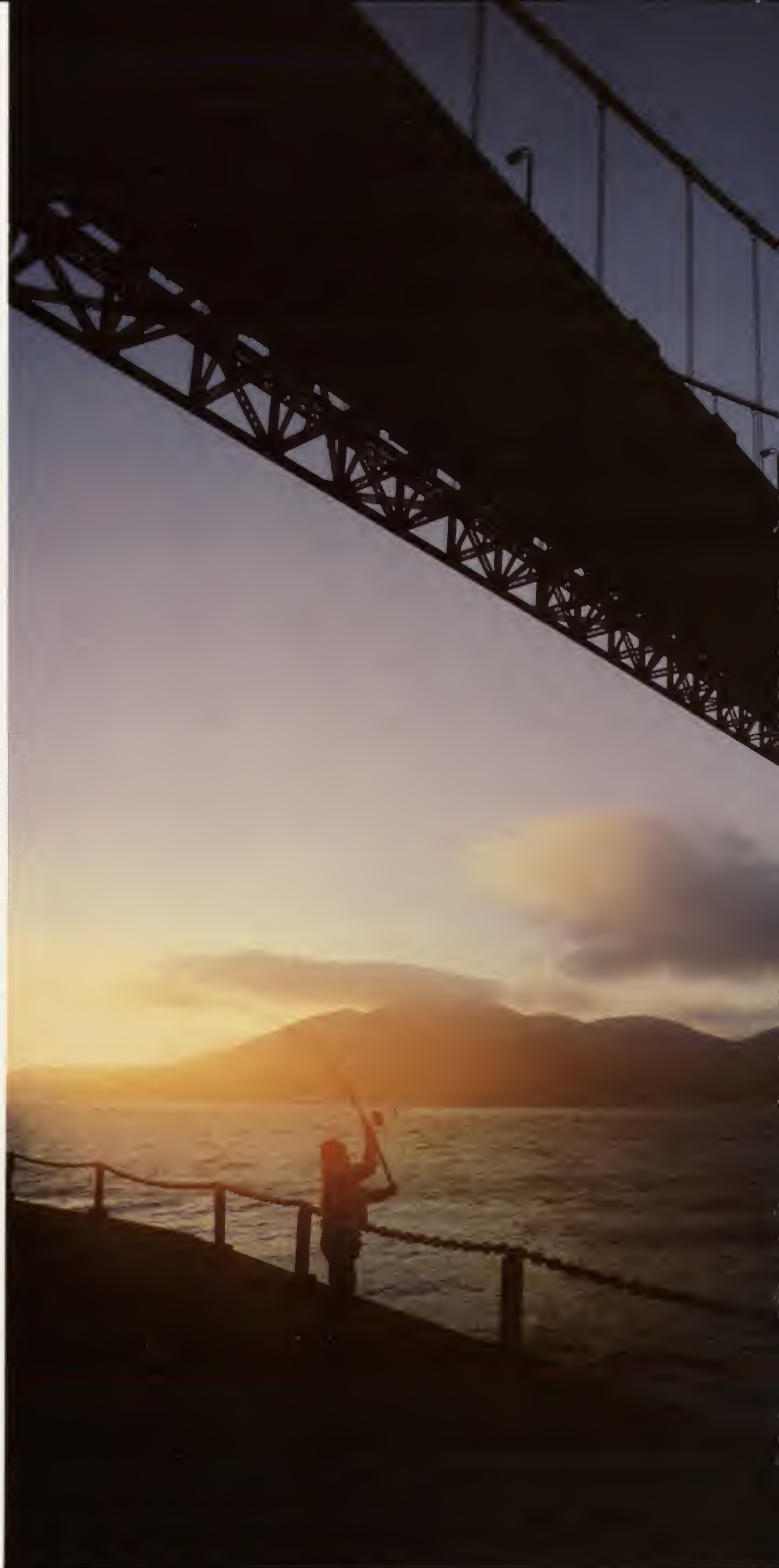
Case sales increased approximately 12 percent, or roughly double the industry average. The company recorded gains in all its brands, in all channels of distribution, in all geographic areas and among all types of bottlers. Each major brand—Pepsi-Cola, Diet Pepsi, Pepsi Light and Mountain Dew—attained record volume levels, and each increased its share of the market.

This level of achievement was attained through the dedicated efforts of a committed and enthusiastic organization of franchise bottlers, the backbone of the company, and the Pepsi-Cola Bottling Group of company-owned bottling operations which has dramatically improved its performance in the last two



At the state rodeo in Douglas, Wyoming, cowboys waiting for their event chat and banter over cups of Pepsi. Suddenly, the tranquil scene is broken by the violence of a bucking bronc or a steer being thrown to the ground. To the spectators, it's a great show; to the competitors, it's a tough contest requiring skill and courage.

The quiet and stillness of this favorite San Francisco fishing spot under the Golden Gate Bridge make you forget the hustle of the nearby freeways and city. Casting out onto the bay, you are at peace with yourself and with the world. A gulp of Pepsi every now and then, right from a big quart bottle, slakes your thirst as the sun climbs higher in the sky.



years. They were assisted by a healthy market environment which sustained an overall soft-drink growth rate conducive to continued expansion and by the implementation of sophisticated and effective marketing, promotion and merchandising programs.

Pepsi-Cola achieved exceptional sales growth in American food stores, the fastest growing segment of the soft-drink business and the only place the consumer has unhampered freedom to choose.

These results, however, were not attained at the expense of efforts directed at other segments of the soft-drink market. There was, for example, a dramatic increase in investment during 1977 in such equipment as new and larger vending machines, where sales increases actually exceeded growth rates in food stores. There was also a healthy expansion in the syrup part of the business due primarily to the addition of fast-food chain accounts.

The introduction of Pepsi-Cola Company's new plastic bottle in March of last year had a very positive impact on those markets in which it was distributed and represented an important milestone in the company's history. It is the first time a new package was conceived within the company, technically proven and brought to the market outside of traditional supply channels. Made of a light, shatterproof polyester, it has won solid consumer acceptance. By the end of 1978, the plastic bottle should be available throughout most of the United States.

A hallmark of its success ever since Pepsi-Cola introduced the first musical jingle in the 1930's has been its innovative and effective advertising. In 1977, the company's infectious "Have A Pepsi Day" theme followed in the tradition of "Join The Pepsi Generation," "You've Got A Lot To Live, Pepsi's Got A Lot To Give," and, most recently, "Join The Pepsi People Feelin' Free." In addition, The Pepsi Challenge, one of 1976's most dramatic and attention-getting advertising innovations, has continued to prove its effectiveness in over 30 percent of U.S. markets. Based on taste tests comparing Pepsi-Cola and Coca-Cola, carried out by an independent testing firm, The Pepsi Challenge showed that nationwide more people prefer Pepsi over Coca-Cola.

Pepsi-Cola Company's other products have also been a great success story in their own right. Marketing efforts in support of each of these products have been designed to develop their individual identities clearly, while, at the same time, to benefit from, and remain compatible with, the outstanding market image of Pepsi.

Diet Pepsi increased its sales and share of market in the first full year since reformulation in 1976. This dramatic growth in sales occurred even though, on March 9, 1977, the Food and Drug Administration proposed a ban on saccharin. The FDA proposal was postponed by Congress for 18 months in November 1977 as a result of strong public opposition to the ban and substantial scientific data challenging the basis of the FDA action. Pepsi-Cola Company has joined with other members of the food industry to fund and promote extensive studies on the safety of saccharin by independent scientists and foundations.

Mountain Dew is the fastest growing soft drink in America. Its unique taste, consumer loyalty, wholesome association with the outdoors suggested by its "Hello Sunshine" advertising theme, and the commitment of the bottler organization to sustain its growth have all contributed to its popularity.

Pepsi Light, a unique cola product with only half the calories of regular soft drinks and a lemony taste, was relaunched in 1977 with a significantly improved formulation that provides more lemony flavor with less aftertaste.

Based on its strategy of building future expansion, Pepsi-Cola Company introduced "On-Tap" into the Milwaukee market last August to test its acceptability to consumers. A smooth, creamy root beer with a long-lasting head and a right-from-the-keg flavor, "On-Tap" was introduced after the demand for just such a product was identified. Initial test results have been extremely encouraging, with further expansion

For 47 summers, the Moosup Valley, Rhode Island Grange has put on a clambake that attracts people from all over the state. Between cans of Pepsi, volunteers stoke and hose down the huge fire where, under a canvas cover, the mounds of clams and fish are steaming in beds of seaweed. Most of those who come are veterans of the affair ("This is my 27th year!") and wouldn't miss it for the world.

anticipated in 1978.

A strong element in Pepsi-Cola Company's success is the favorable image and pleasant associations consumers identify with its products. Together with the company's other marketing efforts, several public relations programs, nationwide in scope, help support this image. One is the Pepsi-Cola sponsored "Hotshot" program, a basketball skills competition which in 1977 involved 2.5 million American young people and over 1,000 separate youth organizations.

For 1978, while continuing the "Hotshot" program, the company will also launch its Diet Pepsi "Run America Run" competition which will begin with a series of qualifying races open to anyone, sponsored by local Pepsi-Cola bottlers with coordination and support from the company. Winners will compete in four regional 10,000-meter events, with the national championships to be held at PepsiCo World Headquarters. An associated promotion will permit interested runners to submit information on their running abilities and receive a computer rating of their capabilities relative to all the others in their category.

International Soft Drinks: For PepsiCo International, 1977 was the best year in its history. Sales volume of Pepsi-Cola, Mirinda flavored beverages and their companion products increased approximately 16 percent, exceeding even domestic soft-drink growth. Contributing substantially to this success were the overseas company-owned bottling operations.

The first annual Pepsi-Cola Tennis Tournament in Cairo, Egypt was a social as well as a sporting event where both Wilson tennis rackets and Pepsi were a center-court pair.

With franchises added in Portugal and Madeira during 1977, Pepsi-Cola is now available in 140 nations and territories outside the United States. Twenty-one additional bottling plants came on stream during the year, for a total of 572, of which 32 are company-owned.

The fundamental reason for PepsiCo International's success in 1977 was the heavy investment in the basics of its business—at levels even higher than in previous years—by both franchise and company-owned bottlers. While Pepsi-Cola and its allied brands are familiar products overseas, the level of market development in many areas is far below that in the United States where soft-drinks have been a major industry for many decades. Consequently, sales of Pepsi-Cola products in markets with great potential abroad have often been limited, not by a lack of consumer acceptance, but by their lack of availability. Investment in bottling plants, machinery, glass and delivery trucks for distribution, therefore, usually results in an immediate increase in sales. These expenditures in the "tools of the trade" and related support spending on such activities as improved training, increased distribution capability and the introduction of flavors where warranted characterized 1977 and developed a momentum in the business which should see further large sales—and even larger earnings—gains in 1978.

In January of last year, United Beverages International (UBI), already responsible for several company-owned bottling operations overseas, received a mandate to take control of the remaining ones. As a result, it now functions abroad within PepsiCo International in the same way the Pepsi-Cola Bottling Group functions domestically within Pepsi-Cola Company. The 32 overseas company-owned bottling plants represent an important part of PepsiCo's international business. UBI's case sales grew in excess of 20 percent over 1976, and its contribution to consolidated corporate earnings more than doubled.

While the division's business as a whole progressed on virtually every front, especially strong advances were made in the Middle East, Morocco, Brazil, Venezuela, Guatemala, Ecuador, the Philippines, Thailand and Japan. In addition, PepsiCo announced in January 1978 a substantial expansion of its commercial agreement with the Soviet Union.

This pioneering trade relationship has been so mutually beneficial that the original agreement has been expanded to authorize a doubling, to ten, of the number of Soviet Pepsi-Cola plants. In addition, to meet soaring demand, substantially more Stolichnaya Russian vodka will be imported into the United States by an independent distributor.

The Middle East represents one of the fastest growing soft-drink markets in the world. In 1977, Pepsi-Cola case sales advanced by more than 30 percent, but sales development is still constrained by inadequate production and distribution capacity. Franchise bottler investments made in 1977 should have a material impact on boosting performance in the Mideast again in 1978.

In Brazil, where sales have been improving at a better than 20 percent rate, further market development for Pepsi-Cola is limited primarily by the availability of glass bottles and, to some extent, bottling equipment. Continued investment in these basics will be combined with marketing support programs for Pepsi and Mirinda, as well as the introduction of new flavors.

As the result of an organizational restructuring in the Philippines, almost entirely serviced by a company-owned bottler, together with additional investment in the basics, case sales increased by more than 32 percent and market share gained substantially.

In Canada, vigorous marketing activity, especially use of The Pepsi Challenge, raised the Pepsi-Cola share of the food-store market to an all-time high and created a momentum which, with a continuation of these efforts, should be sustained through 1978.

Encouraging progress was achieved in other areas as well. In Mexico City, the company-owned operation showed good results, with substantial case sales increases and market-share gains. Mirinda orange, successfully launched there in 1977, will help expand distribution in other high potential areas in 1978.

While the unique characteristics of the Japanese market have in recent years had a depressing effect on Pepsi-Cola sales there, 1977 witnessed a significant turnaround due to increased spending, replacement of the 192 milliliter package


Fritos


543


STOLICHNAYA
Stolichnaya vodka
RUSSIAN

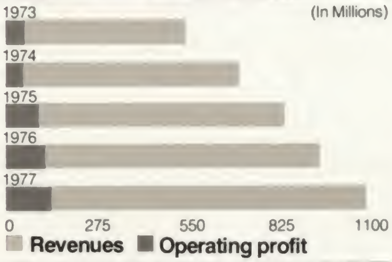
Maneuvering a sailboat off the Atlantic Coast in a stiff southeast breeze requires knowledge and teamwork—but the experience breeds a strong camaraderie among the participants.

with the 300 milliliter package, route restructuring and training.

Though the company's soft-drink case sales in Europe rose by 6 percent, compared to an actual decrease for the industry as a whole, and market share improved everywhere except Spain, unsettled economic conditions, together with unusually cold summer weather, reduced the company growth rate. By concentrating on the food-store market with emphasis on larger package sizes, and by building consumer awareness and brand image, PepsiCo International expects improved 1978 sales and market-share gains in Europe.

Africa at present accounts for a very small portion of PepsiCo's international soft-drink volume and profits, but it has the world's fastest growing population, and its commercial development potential, particularly in Nigeria, makes it an area of great promise for the company. In the next few years, establishment of new franchises and the necessary investment in plant and equipment, as well as training of bottlers' personnel and technical support, should insure a growing and profitable market for the division's products.

FOOD PRODUCTS



Snack Foods: Again in 1977, Frito-Lay turned in an excellent performance. Its sales increased by over 15 percent, and unit-volume growth continued the strong pace of 1976. With its profit margin exceeding PepsiCo's corporate—as well as industry—averages, Frito-Lay remains a great success story for the corporation.

The company's best known products continued to attract growing numbers of customers in the marketplace. Doritos brand tortilla chips, introduced in the mid-1960's, is one of the greatest product successes in the food industry. Lay's and Ruffles brands potato chips also had such a good year that consumer demand strained production capacity, necessitating the construction of new, and the expansion of existing, potato chip plants. Other brand favorites—Fritos brand corn chips, Chee·tos brand cheese-flavored snacks and Rold Gold brand pretzels—while growing at a more modest pace, nevertheless posted record sales. The Go-B-Tweens line of nuts, meats, crackers and cakes sold in small packages for immediate consumption is expanding dramatically from a more modest base to become an important segment of the company's total business.

To achieve these results, Frito-Lay greatly increased the number of new sales routes (695 additions as compared to 260 in 1976, for a total of approximately 7,000 routes) and embarked on an ambitious merchandising campaign which placed over 8,000 secondary display racks in additional locations around the country. These and other efforts, such as the nationwide distribution of Frito-Lay's Natural Style potato chips within one year of its introduction in 1976 and the launching of new advertising campaigns late in the year, required substantial marketing support spending. This was more than offset by increased revenues.

In the face of ever more sophisticated competition, an increasingly important factor in retaining its leadership position is the ability of Frito-Lay to respond to—or stimulate—consumer demand. An industry-recognized strength is the company's capability to improve and extend its products in its various markets while meeting strict standards of consumer acceptance. Two of these products—Tostitos, a round tortilla chip, and Fantastix, a french fry shaped snack with a tangy green onion and zesty cheese flavor—have done well and further market

The Aspen Music Festival is a series of programmed and unprogrammed happenings attracting people from all over the country to the Colorado Rockies. Here, while enjoying some Frito-Lay snacks, a group of spectators listens to an itinerant band of street musicians.

New York City's ethnic diversity is represented by the San Gennaro Festival in the city's Italian neighborhood. Each summer it attracts thousands of people of every conceivable national heritage to eat, play games of chance, watch the clowns or just mingle with the crowds. Frito-Lay snacks and Pepsi are naturally a part of the scene.

gains are expected in 1978.

Other new developments have included the adoption of opaque packaging to increase the shelf life of light-sensitive potato snacks. As the company completes the process of removing all artificial preservatives from its entire product line by the middle of the current year, packaging innovations have taken on greater significance for insuring product freshness. To keep abreast of its ever changing markets, the company's Irving, Texas research, testing and quality control facility has enlarged its space by 40 percent.

Frito-Lay is implementing a major capital investment program to sustain the momentum of its growth. In 1978 it will allot nearly $100 million, mostly for the construction of new, and the expansion of existing, plants (primarily to increase potato and tortilla chip production) and for the purchase of new route and long-haul trucks. One of these projects, begun in 1977, is a new plant in Charlotte, North Carolina which will be the most advanced of all Frito-Lay production facilities when it is completed in early 1979.

Behind Frito-Lay's plans and performance lie a series of organizational and management systems which have proven effective and responsive to change. A fundamental factor in its market success is its "store-door" distribution system which provides the highest level of service in the industry. In this system, sales personnel not only sell to an account, they provide all the services involved in maintaining the in-store display. This means they deliver and arrange the product themselves (usually at least twice each week) and rotate the stock as needed. They are thus able not only to insure that the company's display area conforms to proven merchandising techniques but also to save the store manager the necessity of worrying about Frito-Lay inventory utilizing precious warehouse space.

Also important are the Frito-Lay personnel development and training programs which provide advancement opportunities for employees at all levels through a system of performance evaluation and training. For managers, this involves designing programs for the long-term advancement of exceptional executives.

Cost control, another high Frito-Lay priority, is intimately linked with the purchasing function. For a company which is one of the nation's largest users of such commodities as corn, potatoes and cooking oil, effective purchasing can have a significant impact on company earnings. Frito-Lay is focusing similar efforts on energy and water conservation and on waste treatment. Through greater utilization of existing equipment (the Double in Place program adopted in 1976), the company achieved significant

energy savings—as high as 40 percent on corn-based snack production. Much progress has also been made in the handling of waste materials so that their impact on the environment is minimized. The current objective is to design secondary treatment facilities which would cleanse plant waste water to normal household discharge levels so that it would be compatible with existing sewer systems, greatly easing the plant site-selection process. Water conservation efforts, some already started, include recycling where possible and switching to dry processes which previously required water, such as potato peeling.

International Snack Foods: With sales substantially above those of 1976, PepsiCo Foods International (PFI) has emerged as an important segment of the corporation's total business. Currency devaluations and unfavorable economic conditions, especially in Spain and Canada, reduced PFI's profits, but the company's long-term potential continues to be strengthened by gains in share of market in each country where it operates.

In Mexico, where PFI is the clear market leader, the company had a good year. Its unit sales volume increased by just under 10 percent. Dollar volume remained virtually unchanged despite the 1976 devaluation of the peso. There was significant production capacity expansion of all product lines, a 25 percent enlargement of its nationwide route system and the introduction of two new products: Palomitas brand popcorn and Chee•tos brand cheese-flavored snacks. Its largest selling product is Sabritas brand potato chips, while the Fritos, Doritos and Sabritones (an imitation pork rind snack) brands comprise approximately half of PFI's Mexican sales.

The continued fast growth of the PepsiCo Foods International operation in Brazil has already made that country an important part of the company's total business with great future potential. From a relatively small base, sales have been growing at a nearly 50 percent annual rate, thrusting the company to the number one position in its market. An expanding distribution system and product line is credited for this achievement. In 1978, there will be continued emphasis on increasing routes and product availability.

In Venezuela, where PFI is engaged primarily in the manufacture and sale of high quality pasta products bearing the highly respected La Vienesa name, sales and profits rose more than 20 percent over 1976. The company plans to enlarge its distribution network in 1978 and to increase the sales of a newly introduced powdered soft drink mix by adding two new flavors.

In Puerto Rico, PFI completed construction of its new manufacturing facility, thereby reducing the need to import products from Frito-Lay in the United States.

PFI's Canadian company successfully launched an all-natural potato chip called Home Style, the first new-product introduction in the Canadian snack-food market in several years. It also completed the integration of the Raymond Snack Food Company acquired in 1976 and expanded the production capacity for Fritos and Doritos brands.

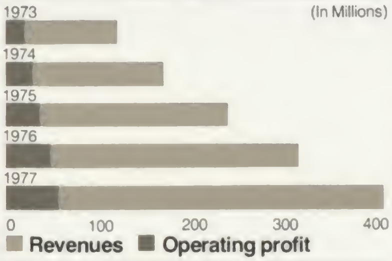
The 25 percent devaluation of the Spanish peseta, unexpectedly high inflation, and a generally weak economy resulted in a 1977 reduction in the rate of profit increase for PFI in Spain on sales which were still nearly 25 percent above the previous year's. Nevertheless, the company is in a good position to capitalize on an upturn in the economy because of its market leadership.

For 1978 and the future, the PFI strategy for growth is to insure that it is a major factor in the markets of countries which are experiencing rapid population growth and, in more mature economies, to develop those sections of the market for which established PepsiCo snack-food products have significant potential.

The sun of Brazil's January summer attracts the people of Rio de Janeiro to the incomparable beach at Ipanema as if by magnetic force. They sunbathe, swim, play frisbee and soccer—and for snacks they munch on Chee•tos, Baconzitos or Chips brand snacks, manufactured and distributed there by a PepsiCo Foods International company.

Checkered tablecloths, friendly service and—especially—good food: these are the ingredients for family enjoyment at Pizza Hut restaurants.

FOOD SERVICE



The addition of Pizza Hut and its system of over 3,200 company-operated and franchised restaurants has contributed a whole new dimension of service to PepsiCo's consumer-oriented food operations. Because its customers tend to be the same ones already attracted to PepsiCo's other products and services—young people and families on the move—and also because a major part of PepsiCo's soft-drink and transportation businesses involve working with franchises, the match was a natural one from which both companies anticipate substantial benefits.

The increase in Americans' leisure time, the growing tendency for both husbands and wives to be employed, and the number and frequency of people eating away from home make the continued strong domestic growth of Pizza Hut the primary area of expansion for the near-term future. However, with over one hundred Pizza Hut outlets already in 12 foreign countries, the company is also committed to expanding its overseas business and sees this as an area of growing importance. PepsiCo's depth of international experience and expertise will be of great use in this effort.

The beginnings of Pizza Hut 20 years ago in Wichita, Kansas were very modest, but its expansion was so rapid that, by 1968 when it was ten years old, it already had 300 restaurants in its system and had moved to enlarge their menus and to standardize their appearance through the adoption of the distinctive red Pizza Hut roof. In the late 1960's the company acquired Franchise Services, Inc. (FSI) which has become the major supplier for the entire system's food, equipment, paper, warehousing and distribution needs. Today, Pizza Hut outlets operate in 49 of the 50 states, and FSI annually supplies more than 36 million pounds of cheese, 1.5 million cases of California tomatoes, 35 million pounds of meat and 2 million pounds of its secret-blend spices to the system.

In 1977, Pizza Hut management established a goal of adding 400 new units to its system, 200 to be built by the company and 200 by franchisees. In fact, however, over 540 new restaurants were added—an average daily rate of nearly 1.5 restaurants. Although fourteen years were required to reach the first thousand restaurants and three years for the second thousand, it took only two years for the third thousand. A special ceremony was held in October in Arlington, Texas, the state with more Pizza Hut restaurants than any other, to celebrate the opening of the system's 3000th unit.

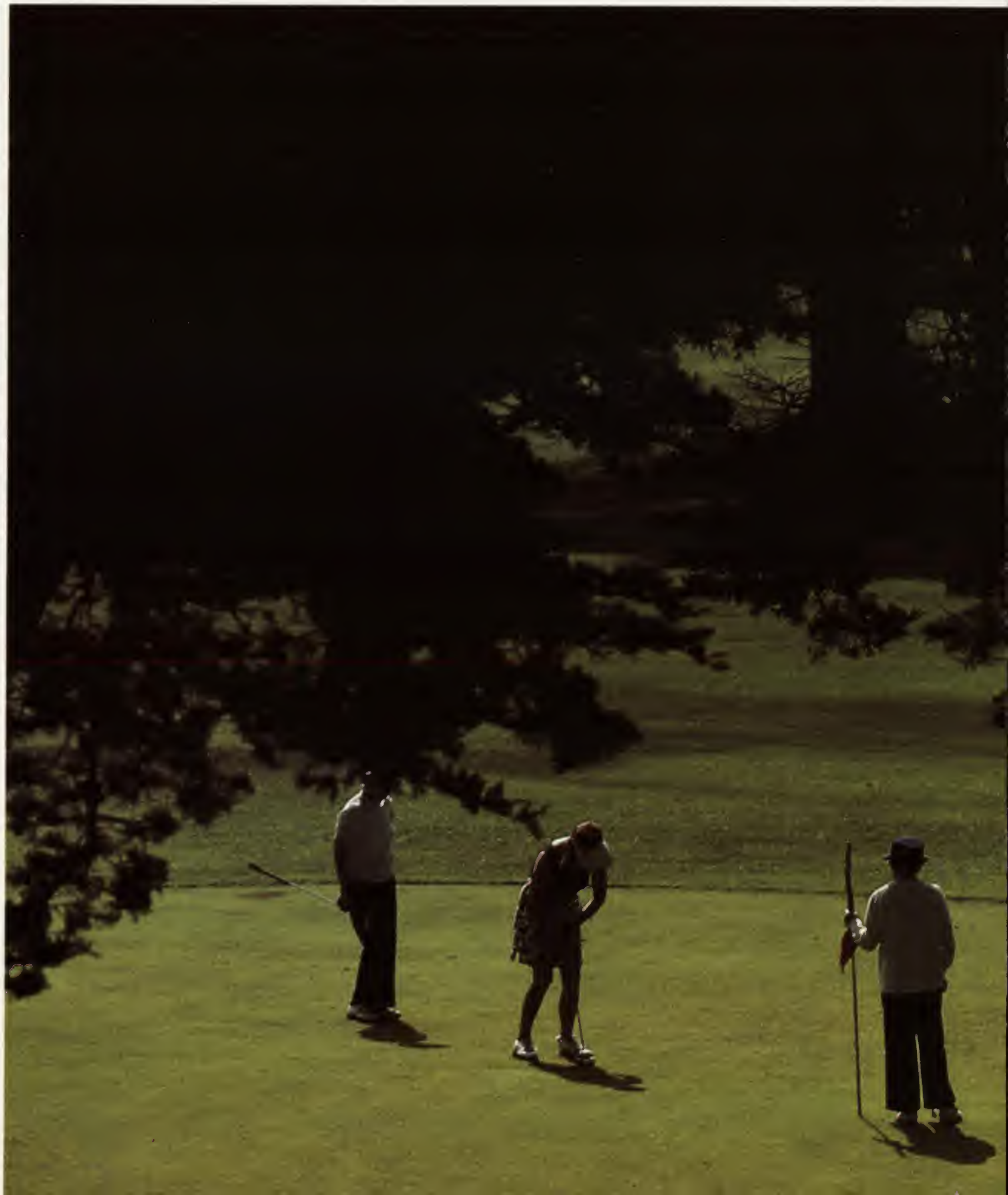
This rapid expansion has been carefully planned. Over the last five years, in fact, Pizza Hut pre-tax profits have risen approximately 400 percent on a like growth in net sales. The ability to perceive, and the resources to capitalize on, changing social trends, demographic patterns and national eating habits, together with sophisticated operational techniques and marketing programs, comprise the main reasons for the success of Pizza Hut.

To its original menu of pizza, beer and soft drinks, Pizza Hut has over the years enlarged its bill of fare to include "Thick 'N Chewy", and "Thin 'N Crispy" brand pizzas, together with Cavatini deep dish pasta, spaghetti and salads. In 1976, it added meatball and Italian sausage sandwiches, and last year enlarged its pizza selection with the top-of-the-line Super Supreme brand pizza. Sensitive to regional differences in taste, the company continues to serve the needs of its customers through product adaptation in local markets.

Supporting company growth and product development has been a series of marketing and promotional activities which also have changed over time. Its first advertising jingle—"Putt, Putt To The Pizza Hut"—was originated in the mid-1960's and became the basis for a full-fledged advertising campaign. The theme subsequently changed to "There Are A Lot Of Good Things Under Our Roof."

Super Supreme pizza

A foursome, well equipped with Wilson balls and clubs, plays out a hole on a quiet course in Portland, Oregon.



In 1976 the company retained a larger advertising agency offering a broader base of services and adopted the present "Let Yourself Go To Pizza Hut" theme which proved very successful and will be used again in 1978.

To insure that all products utilized in Pizza Hut restaurants meet the company's stringent standards, a team of quality control and sanitation specialists continually monitor them. Frequent inspection visits are made to the restaurants, and store personnel are trained in proper food-handling and sanitation techniques.

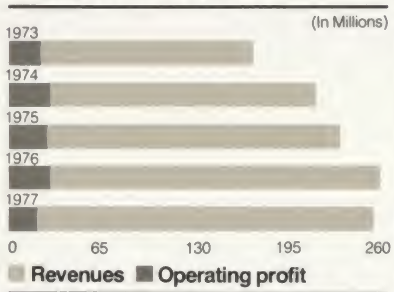
Pizza Hut has undertaken a national evaluation of its pizza products and prominently displays the results in Pizza Hut restaurants. In studies conducted by independent research organizations, pizza has been determined to be more nutritious than the food offered by most fast-food chain restaurants.

In order to expand its already large share of the dining-out market, the company in 1974 launched a new chain of restaurants called Applegate's Landing. Each of the 10 now in operation are larger than Pizza Hut restaurants, have a natural-wood and antique motif and offer a more varied menu. Company management believes Applegate's Landing offers significant growth potential and has plans for the opening of several new restaurants in 1978.

In December of last year, Pizza Hut moved into a new corporate headquarters building which incorporates a number of important technological and design features. The emphasis placed on energy conservation throughout its restaurant system is reflected in the 40 percent-per-square-foot reduction it achieved in energy usage compared to the previous corporate headquarters. This results from a much smaller glass-to-floor-area ratio, the recycling of heat generated by normal computer usage to warm the building in cold weather, and the circulation of outside air in warmer periods.

Together with its business development efforts, Pizza Hut has established a strong commitment to involving itself in community affairs. The best known example is the famous Pizza Hut Basketball Classic which, for the seventh consecutive year in 1978, will pit an East team against a West team, both made up of college seniors selected by Pizza Hut customers, with all proceeds going to charity.

SPORTING GOODS



Responding to a significantly different market for its products—characterized by far slower growth than the sporting goods "boom" years of the early-to-mid-1970's and a greatly intensified competitive environment—Wilson has utilized 1977 to reorganize and reposition its business to capitalize profitably on emerging consumer trends. While this has entailed heavy spending for the future and, when combined with oversupply and smaller-than-usual sales gains, has resulted in a decline in profits for the year, Wilson anticipates a return to better sales and earnings increases that will develop a momentum to carry it successfully into the next decade.

A complete reorganization shortly after midyear—restructuring the company into three separate sports divisions—Racket Sports, Golf, and Team Sports—now permits a more focused concentration of management and technical expertise on clearly delineated performance objectives reflecting the particular needs of each product category. Salesmen in each division, for example, will be able to focus on marketing, merchandising and promotional programs designed solely for that product group and not spread themselves too thinly over the whole range of Wilson products.

Inherent in the reorganization is a stepped-up commitment by the company to determine the needs of the marketplace in each sports category and to market products which will respond to them. The results can be seen in the introduction by all of the Wilson divisions of additional products and line

Wilson Reflex clubs

With an intensity rivaling that of their older heroes, these young Arizona football players in Phoenix's Pop Warner Football League execute a complicated running play in professional style. Wilson footballs and equipment are an important part of the activity.

extensions which have the potential for expanding the company's market position.

Additionally, in order to increase its productivity as well as to improve its responsiveness to changing competitive conditions, Wilson has begun to move into its own production of some products—primarily inflatable products—which it formerly subcontracted. For this purpose, it is at present completing construction of a 165,000 square-foot plant in Humboldt, Tennessee, which will produce most of the company's inflatable products.

Wilson's Racket Sports Division retained its share of a tennis market which grew only about one third as fast as it did in 1976. In markets where Wilson traditionally has been among the leaders—wood and steel rackets—the company improved its position with strong sales of high performance rackets aimed at players interested in upgrading their equipment. For example, sales of Wilson's premium wood racket, the Advantage, grew 25 percent over 1976, benefitting from strong marketing efforts. In September, Wilson introduced an advanced steel-framed racket—the T5000—which has a special vibration-dampening feature and a new, high-density string pattern for improved control. In December, Wilson began its first move into the fast-growing composite racket segment of the tennis market with the introduction of the Ultra, a pure graphite racket incorporating four special tungsten weights at the sides of the racket head. This latest technological advance makes the Ultra superior to any graphite racket on the market.

In tennis balls, Wilson introduced a new "Extra Duty" ball which wears 23 percent longer than any competitive product. Additionally, a special indoor ball was introduced which not only wears longer, but counteracts the "shagging", which occurs on indoor surfaces. In clothing, the company's Designer line achieved record growth as sales expanded into better department and specialty sporting goods stores. Wilson expects strong growth from its clothing line in the future. Finally, the Racket Sports Division expanded its participation in the racquetball market with a full line of rackets and balls.

While golf club sales for the industry as a whole were virtually flat, the company retained its share of market. Wilson 1200 clubs sold well in pro shops around the nation and the Wilson Staff clubs won more money on the professional circuit in 1977 than any other single model. The Onyx clubs, a 1976 introduction designed for women as part of the Walter Hagen line, were also well received.

In a new move which promises to have a significant impact on the future of

Wilson Ultra and T5000

golf, Wilson has achieved a technological breakthrough with the introduction in January of the current year of its new Reflex line of clubs with a specially designed head made of stainless steel with a narrow slot behind the club face. On impact with the ball, the Reflex iron head flexes, adding greater power and distance and providing a surer feeling of control. Initial sales reports are encouraging.

During the year, the Golf Division also focused increased attention on the "consumable" portion of its product line: balls, bags and gloves. Partly as a result of a first-in-the-industry marketing effort in which sample balls were mailed to over 600,000 avid golfers, Wilson ProStaff golf balls moved to third place in the industry only a year after their introduction in 1976. Additionally, the company introduced the Aviator, a golf glove with a pre-curved palm.

Sales in the company's Team Sports Division increased significantly, benefitting primarily from a strong resurgence of interest in organized sports activities. In football, where Wilson has for years been the official ball of the National Football League, sales of its footballs increased almost 20 percent, reflecting strong retail demand. Similarly, in basketball, where Wilson is the official ball of the National Basketball Association, the company enjoyed increased sales of its leather and rubber balls. Strong sales gains were also registered in the baseball category where the Wilson A2000 glove is recognized as the unquestioned leader in its field, and the company increased its emphasis on softball, a sport with strong future growth potential.

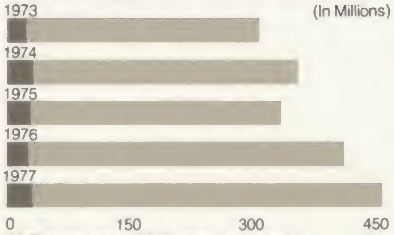
Wilson Poly Match Pro [illegible]

The most important development during the year for the Team Sports Division was its increased commitment to the fast-growing athletic footwear market, through the introduction of a full line of shoes under the Wilson brand. This new line of athletic footwear, manufactured in conjunction with the Bata Shoe Company, the world's largest shoe manufacturer, will compete in every major market segment. Already, Wilson shoes are represented in tennis, basketball, racquetball, baseball, football, soccer and will expand to several other sports shortly. Through a cooperative promotion effort with Pepsi-Cola Company, Wilson shoes have been designated the official shoe of the Pepsi-Cola "Hotshot" program, a basketball skills contest involving millions of American young people, and the Diet Pepsi "Run America Run" program to be launched nationwide during 1978.

With interest in team sports participation expected to remain at high levels, Wilson intends to enlarge its efforts, especially in such increasingly popular sports as softball, volleyball and soccer.

With much of their equipment produced by Wilson, a women's semi-professional softball team from Venezuela is shown here in action against a team from Milford, Connecticut, a state which has produced some of the all-time great women softball stars.

TRANSPORTATION



In 1977, northAmerican Van Lines (NAVL), which has largely managed to overcome the cyclical nature of the moving business generally, had one of the best years in its history. The strong increase in revenues and profits it achieved was a function of its ability to service the transport needs of families and businesses in a resurgent economic environment.

The largest segment of NAVL's business, the moving of household goods, had the sharpest increase in shipments in the company's history, straining its resources in the latter part of the summer, the peak moving season. The pent-up demand for moving services, occasioned by the recession of 1974 and 1975, began to emerge in the latter part of 1976 and continued strong throughout 1977. Moves by individuals, up by a fifth over the previous year, were followed closely by a substantial rise in transfers by companies, both sure signs of improved confidence. For 1978, NAVL expects another good year for its Household Goods Moving Division but with increases probably somewhat below 1977 levels. Its efforts will be devoted to expanding its agent network and further improving its level of service, which is already high by industry standards.

The fastest growing portion of NAVL's business is in the transport of new products such as household appliances and furniture direct from the manufacturer to warehouse or retail showroom. The New Products Division had a very good year in 1977 and anticipates continued progress in 1978.

Revenues from transport of high value products such as computer components and photostatic copiers, another NAVL specialty, rose solidly in the last two quarters of 1977 after a sluggish first half. With its elite cadre of highly trained drivers who are also expert in loading and unloading extremely delicate equipment, NAVL can move and install at destination uncrated machinery which formerly had to be broken down and crated for shipment. Technological advances, however, have reduced the size of many of the sophisticated machines traditionally carried on NAVL trucks so that future growth must come through shipment of non-traditional but valuable commodities which require the special handling capabilities of the company's High Value Products Division.

NAVL's international operations, while up slightly in revenues, have been negatively affected by the reduction in its services to the U.S. military and also because the increasingly high cost of maintaining U.S. executives overseas has reduced the number of overseas corporate transfers.

Lee Way Motor Freight, the general commodity freight carrier acquired by the corporation in 1976, experienced revenue growth exceeding the industry average and increased that portion of its shipments which are most profitable.

Having greatly increased its route operating authority and expanded the number of its terminals by more than 30 percent, 1977 was also characterized by an emphasis on development and consolidation. A strong management team is in place and succeeded during the year in integrating the company's enlarged service capability into its extensive existing network.

This involved the restructuring of the sales and operations functions, making sales management a line responsibility more closely coordinated with terminal operations for a smoother functioning of the whole organization. Staff responsibilities, especially in marketing and market research, were also strengthened and resulted in upgraded sales training programs and an ongoing campaign to land national accounts in industries where Lee Way specializes.

A new operating authority and an additional terminal, both in Ohio, were acquired during the year giving the company important operating rights in that state, as well as a better foothold for expanded service to the

With the wheat already harvested but the corn still on its stalks, northAmerican travels to a farm in rural Indiana to help a family relocate to a new home.

Midwest and South. In addition, Lee Way has invested in an on-line freight billing system which will become fully operational in 1978; it constitutes an important step in improving service to the customer.

For the current year, Lee Way is emphasizing increased productivity by soliciting heavily in those segments of its business where its trucks are returning empty, as well as by upgrading the efficiency with which shipments of whatever size move through the system.

PepsiCo Building Systems (PBS) which manufactures and rents relocatable modular structures, performed well in 1977. It opened two new regional offices, in Houston and Phoenix, and successfully completed a 160-unit project for Saudi Arabia.

For 1978, PBS intends to enter two new regional markets in the Sunbelt and will place continued emphasis on a reduction of its manufacturing costs.

In his freshly washed truck, a Lee Way driver in Houston, Texas sets off from the company terminal for his first run of the day.

Analysis of Operations:

PepsiCo continued its unbroken record of annual gains by setting new highs in revenues and earnings in 1977, and, for the third consecutive year, earnings growth exceeded 20%. In 1977 sales and other operating revenues (restated to include Pizza Hut) increased 17% over the prior year to a level of $3.55 billion. This followed a 1976 increase of 14% to $3.03 billion. Net income, also restated, rose 22% in 1977 to $187.3 million after a gain of 29% in 1976 to $153.8 million. After the three-for-one stock split in May 1977, earnings per share in 1977 amounted to $2.15, a 19% increase over the $1.80 per share in 1976. Earnings for 1975 were $1.41 per share. All of these figures reflect both the combination of PepsiCo and Pizza Hut on a pooling of interests basis and the early compliance by PepsiCo with the accounting treatment for capital leases prescribed by Statement of Financial Accounting Standards No. 13. It should also be noted that PepsiCo's 1977 fiscal year encompassed 53 weeks compared with 52 weeks in 1976 and 1975 and that the fourth quarter of 1977 covered 17 weeks compared with 16 weeks in 1976 and 1975.

For the five year period ended December 31, 1977, annual compound growth rates for PepsiCo were 17.8% for revenues, 18.6% for net income and 17.3% for earnings per share. This exceeds by far the performance in any prior five year period in PepsiCo's history.

Reviewing the principal changes in 1977 and 1976, the strong revenue increases in both years were due mainly to substantial growth in unit volumes. In 1977, price increases and changes in mix accounted for approximately a fourth of the dollar gains. Except for sporting goods, volumes increased in all lines of business in 1977 and were particularly strong in beverage and food products. After considerable improvement in 1976, the gross profit margin increased an additional 1.1 percentage points in 1977 reflecting substantial gains in the beverage and transportation margins. Marketing, administrative and other expenses increased 20% in 1977 after an 18% increase in 1976 reflecting PepsiCo's continuing emphasis on new products and other business-building programs to support the current and future growth. Such investment spending continued at a high level for the third year in a row (e.g. advertising expense increased 31% in 1977 and 36% in 1976) and surpassed, in the final quarter of 1977, the particularly large amounts spent in the fourth quarter of 1976. This tended to narrow operating margins slightly in the fourth quarter of 1977, and, as in 1976, caused a reduction in net income from the third quarter, despite a higher sales level in that period. Foreign currency translation losses, most of which were incurred in the fourth quarter of their respective years, were $7.8 million in 1977 (principally related to a translation adjustment on the Swiss franc loan) and $4.3 million in 1976. In other respects, fourth quarter results continued the trends established in earlier quarters. Administrative and other expenses also included substantial increases in pension expense and, in 1976, a charge of $4.5 million associated with the sale of PepsiCo's truck leasing operations.

There was very little change in 1977 in the net cost of interest expense less interest income, following the sizeable reductions accomplished in 1976 and 1975. In 1977, interest expense remained relatively constant as average corporate debt changed only slightly from 1976. While marketable securities and other investments, combined, increased nearly $19 million during 1977 to $251 million, related interest income decreased slightly due to a somewhat lower yield on the portfolio, resulting principally from changes in tax regulations.

The provision for U.S. and foreign income taxes was 45.5% of income before such taxes in 1976 and 44.4% in 1977. The reduction in the tax rate resulted from several factors, none of which individually was significant. The increase of 0.7 percentage points in the 1976 rate from 44.8% in 1975 was due primarily to a lower proportion of unremitted earnings from foreign operations that are subject to an aggregate tax rate of less than 48%.

Continued attention to productivity and control of costs generated additional improvements in margins and returns for PepsiCo in 1977. Profit per dollar of revenue rose from 8.0% in 1975 and 9.3% in 1976 to 9.5% in 1977 on a pre-tax basis and from 4.5% in 1975 and 5.1% in 1976 to 5.3% in 1977 on an after-tax basis. As a result of these gains and careful management of asset utilization and capital expansion, return on assets employed continued its trend of marked improvement from 11.3% in 1975 and 13.3% in 1976 to 14.5% in 1977. At the same time, return on shareholders equity achieved a new record level of 19.3%, a gain of 1.1 points in 1977 following the sharp rise of 1.3 points in the prior year.

Lines of business: The data for years prior to 1977 have been restated for leases qualifying as capital leases and for the merger with Pizza Hut (see Note 1 and Note 2 of Notes to Consolidated Financial Statements) and to reflect the allocation among the lines of business of certain operating expenses not directly traceable to them, as required by Statement of Financial Accounting Standards No. 14 for reporting on business segments.

Revenues (in millions)	1977		1976		1975		1974		1973	
	$	%	$	%	$	%	$	%	$	%
Beverage	1,406.8	40	1,160.5	38	1,064.9	40	981.6	41	829.4	43
Food products	1,048.3	30	911.9	30	806.7	30	673.4	28	521.9	27
Food service	396.2	11	303.2	10	231.2	9	164.8	7	115.0	6
Transportation	444.3	12	401.9	13	327.7	12	344.2	15	279.8	15
Sporting goods	250.1	7	253.1	9	226.9	9	210.6	9	166.9	9
Total	3,545.7	100	3,030.6	100	2,657.4	100	2,374.6	100	1,913.0	100
Foreign portion	686.0	19	569.5	19	535.0	20	462.6	19	376.2	20
Operating Profit (in millions) (1)										
Beverage	180.2	46	143.5	42	111.4	40	114.0	49	101.3	51
Food products	116.3	30	106.5	31	87.4	31	38.3	17	43.1	22
Food service	51.9	13	43.7	13	32.5	12	24.2	10	16.8	8
Transportation	25.6	7	21.3	6	22.7	8	26.8	12	19.4	10
Sporting goods	16.4	4	26.5	8	24.8	9	27.2	12	19.0	9
Total	390.4	100	341.5	100	278.8	100	230.5	100	199.6	100
Foreign portion	52.8	14	49.2	14	46.2	17	40.1	17	43.8	22

(1) Excludes general corporate expenses and interest expense (net) which totaled as follows (in millions): 1977, $53.2; 1976, $59.3; 1975, $66.2; 1974, $61.6; 1973, $42.2.

There were important gains in revenues and operating profits in 1977 in all lines of business except sporting goods. The beverage line had another outstanding year with a substantial increase in sales and profits resulting from major gains in unit volumes (approximately 12% case sales increase domestically, and even stronger overseas) and improved operating profit margins, which had increased 1.9 percentage points in 1976 and another 0.4 percentage point in 1977 despite the higher level of investment spending.

In food products, volume and sales growth continued strong in 1977, while profits grew somewhat more slowly than sales, partly due to large swings in currency exchange rates in several key foreign markets. In the prior year, profits had grown somewhat faster than sales.

The food service business reflected major gains in revenues and profits in 1977 with the margin down slightly due to a lag in price increases to recover substantially rising costs and the considerably faster rate of new unit openings in 1977. In 1976, the margin had risen slightly.

The transportation division had a substantial improvement in profitability in 1977, after a decline in 1976, reflecting good gains in the trucking business in both revenues and profits and the better results in PepsiCo Building Systems. PBS had lower revenues but better profits in 1977 following completion of the Florida school contract in 1976.

Sporting goods reflected a substantial decline in profits in 1977, following a modest increase the year before, resulting from a difficult industry situation characterized by an imbalance between supply and demand and extensive discounting, and substantial expenditures by Wilson for reorganization, consolidation and product development designed to improve the future outlook. While total sales for the year were down slightly, the trend within the year was uneven, with first half sales down substantially and second half sales showing a turnaround with a gain over the prior year.

In both years, 1976 and 1977, PepsiCo's operations outside the U.S. accounted for 19% of the total worldwide revenues and 14% of total contribution to income before taxes and corporate interest and expenses. Foreign revenues grew somewhat faster and foreign earnings somewhat slower than the growth rates experienced in the domestic operations.

Stock Price and Dividends:

The market price range for PepsiCo stock on the New York Stock Exchange and the dividends declared in each quarter of the last two years are set forth in the table below. Quarterly dividends were increased 20% in February 1977 from 16⅔¢ to 20¢ per share and in December 1977 the dividend was further increased to 22½¢ per share for a total increase in 1977 of 35%. The stock price increased generally in 1976, dipped in mid-1977, and reached a new high for the year in late 1977, thereby outperforming the general market averages for the period as a whole.

All amounts are adjusted for the three-for-one stock split approved by the shareholders in May 1977.

	Market Price Range ($)			
Quarter	High	Low	Close	Dividend Declared
1976				
1st Qtr	25½	23¼	24⅛	13⅓¢
2nd Qtr	25½	23⅛	23⅝	16⅔¢
3rd Qtr	28⅝	23⅝	28⅜	16⅔¢
4th Qtr	29⅛	24⅝	25⅝	16⅔¢
1977				
1st Qtr	26¾	22⅝	24¼	20¢
2nd Qtr	25	22⅜	23⅞	20¢
3rd Qtr	27	22⅜	25½	20¢
4th Qtr	28⅝	24⅛	28	22½¢

Capitalization and Financing:

Total consolidated debt of PepsiCo before capitalization of leases rose by $9.4 million, principally reflecting the utilization of favorable financing of certain capital projects by issuance of industrial revenue bonds. Including capital leases, debt rose by $22.7 million to $474.9 million. At year-end 1977, the ratio of total debt to total capitalization improved to 26.5% from 28.7%. Including capitalization of leases, this ratio was 32.8% at the end of 1977, down 2.0 points from the comparable figure of 34.8% a year earlier. In 1978, it is expected that internal cash flow and available resources held in marketable securities should be sufficient to finance virtually all the anticipated surge in capital spending.

PepsiCo's financial position continued to strengthen in 1977 as shareholder equity increased by $126.0 million to $971.8 million, while the total debt increase was held to $22.7 million.

	1977	1976*
	(in thousands)	
Short-term debt—domestic	$ 349	$ 537
—foreign	37,576	41,836
Total short-term debt	37,925	42,373
Long-term debt—current	3,700	3,386
—non-current		
—senior	256,728	243,124
—subordinated	54,981	55,029
Total long-term debt	315,409	301,539
Total debt	353,334	343,912
Capital lease obligations		
—current	5,414	4,756
—non-current	116,141	103,524
Total capital lease obligations	121,555	108,280
Total debt and capital lease obligations	$474,889	$452,192

*Restated to include Pizza Hut

Capital Expenditures:

Expenditures for plant and equipment in 1977 (excluding capital leases) set new records for PepsiCo. Before inclusion of Pizza Hut and capital leases, capital spending rose from $121.6 million to $175.0 million. Including Pizza Hut, such spending amounted to $240.7 million in 1977, compared with $157.5 million in 1976. Because of the need to expand facilities even further to support the rapid growth of the business, particularly in the soft drink and food businesses, capital spending is anticipated at an even higher level in 1978, in the vicinity of $325 million.

Consolidated Balance Sheet (in thousands)
PepsiCo, Inc. and Subsidiaries
December 31, 1977 and December 25, 1976

		1977	1976
Assets	**Current Assets**		
	Cash	**$ 30,351**	$ 31,456
	Marketable securities, at cost (approximates market)	**225,985**	228,982
	Notes and accounts receivable, less allowance: 1977—$15,703; 1976—$17,716	**372,035**	322,470
	Inventories	**314,314**	268,285
	Prepaid expenses and other current assets	**37,336**	37,629
		980,021	888,822
	Long-Term Receivables and Investments		
	Long-term receivables	**26,703**	44,656
	Investments	**24,884**	2,979
		51,587	47,635
	Property, Plant and Equipment		
	Land	**65,014**	52,844
	Buildings	**242,671**	199,316
	Machinery and equipment	**778,312**	639,162
	Capital leases	**148,928**	132,250
	Bottles and cases (net of customers' deposits: 1977—$28,832; 1976—$22,854)	**22,545**	19,260
		1,257,470	1,042,832
	Less accumulated depreciation and amortization	**417,374**	362,837
		840,096	679,995
	Goodwill—cost in excess of net assets of companies acquired	**140,597**	137,560
	Other Assets	**34,990**	33,647
		$2,047,291	$1,787,659

See accompanying notes.

Liabilities and Shareholders' Equity		1977	1976
	Current Liabilities		
	Notes payable (including current installments on long-term debt and capital lease obligations)	**$ 47,039**	$ 50,515
	Accounts payable	**204,956**	155,959
	United States and foreign income taxes	**84,825**	74,187
	Other accrued taxes	**30,645**	31,784
	Other current liabilities	**196,663**	156,376
		564,128	468,821
	Long-Term Debt	**311,709**	298,153
	Capital Lease Obligations	**116,141**	103,524
	Other Liabilities and Deferred Credits	**26,266**	24,838
	Deferred Income Taxes	**57,200**	46,500
	Shareholders' Equity		
	Capital stock, par value 5¢ per share; authorized 100,000,000 shares; issued and outstanding: 1977—86,859,458 shares; 1976—86,526,579 shares	**4,343**	4,326
	Capital in excess of par value	**161,339**	156,384
	Retained earnings	**806,165**	685,113
		971,847	845,823
		$2,047,291	$1,787,659

Consolidated Statement of Income and Retained Earnings (in thousands except per share amounts)

PepsiCo, Inc. and Subsidiaries
Years ended December 31, 1977 (fifty-three weeks) and December 25, 1976 (fifty-two weeks)

		1977	1976
Revenues	Net sales	**$3,096,907**	$2,655,511
	Other operating revenues	**448,807**	375,101
		3,545,714	3,030,612
Costs and Expenses	Cost of sales	**1,502,163**	1,327,454
	Cost of other operating revenues	**344,273**	284,050
	Marketing, administrative and other expenses	**1,343,203**	1,119,341
	Interest expense	**42,091**	41,439
	Interest income	**(23,222)**	(23,865)
		3,208,508	2,748,419
		337,206	282,193
	Provision for United States and foreign income taxes (including deferred: 1977—$7,500; 1976—$6,400)	**149,867**	128,345
Net Income		**187,339**	153,848
	Retained earnings at beginning of year, as restated	**685,113**	578,523
	Cash dividends (per share: 1977—$.825; 1976—$.633)	**(66,287)**	(47,258)
	Retained earnings at end of year	**$ 806,165**	$ 685,113
Net Income Per Share		**$ 2.15**	$ 1.80

See accompanying notes.

Consolidated Statement of Changes in Financial Position (in thousands)

PepsiCo, Inc. and Subsidiaries
Years ended December 31, 1977 (fifty-three weeks) and December 25, 1976 (fifty-two weeks)

		1977	1976
Financial Resources Provided	Operations		
	Net income	**$187,339**	$153,848
	Depreciation and amortization	**89,907**	76,280
	Deferred income taxes	**7,500**	6,400
	Other	**9,118**	7,371
	Total from operations	**293,864**	243,899
	Long-term debt	**19,275**	3,255
	Long-term receivables	**17,953**	(6,822)
	Capital lease obligations	**12,617**	14,999
	Property disposals	**11,815**	19,857
	Capital stock (including conversion of debentures and notes)	**4,972**	34,695
	Disposal of leasing operations	**—**	21,648
		360,496	331,531
Financial Resources Applied	Plant and equipment	**259,598**	178,725
	Dividends	**66,287**	47,258
	Investments in securities	**21,426**	—
	Long-term debt	**11,209**	53,323
	Bottles and cases, net	**3,285**	(2,988)
	Other	**2,799**	(457)
		364,604	275,861
	Increase (decrease) in working capital	**$ (4,108)**	$ 55,670
Increase (Decrease) in Working Capital, by Element	Cash	**$ (1,105)**	$ 5,016
	Marketable securities	**(2,997)**	48,670
	Notes and accounts receivable	**49,565**	47,498
	Inventories	**46,029**	28,416
	Prepaid expenses and other current assets	**(293)**	1,160
	Notes payable	**3,476**	16,505
	Accounts payable	**(48,997)**	(25,835)
	United States and foreign income taxes	**(10,638)**	(34,362)
	Other accrued taxes	**1,139**	(6,925)
	Other current liabilities	**(40,287)**	(24,473)
	Net increase (decrease) in working capital	**(4,108)**	55,670
Working Capital at Beginning of Year		**420,001**	364,331
Working Capital at End of Year		**$415,893**	$420,001

Note 1/Summary of significant accounting policies:

Principles of Consolidation. The consolidated financial statements include the accounts of PepsiCo, Inc. and its subsidiaries. All significant intercompany transactions have been eliminated.

Inventories. Inventories are stated at the lower of cost (computed on the average or first-in, first-out method) or net realizable value.

Property, Plant and Equipment. Land, buildings, and machinery and equipment are stated at cost. Depreciation is calculated principally on a straight-line basis over estimated useful lives of the respective assets. Upon the sale or retirement of property, the property accounts and related depreciation reserves are appropriately adjusted and any profit or loss is reflected in income. Maintenance and repairs are charged to expense as incurred.

Buildings and equipment, which are used or occupied by PepsiCo, Inc. and its subsidiaries under leases which qualify as capital leases pursuant to Statement of Financial Accounting Standards No. 13, have been included in the consolidated financial statements for the first time in 1977. The consolidated financial statements for 1976 have been restated to conform with 1977. The restatement had the effect of decreasing retained earnings at December 27, 1975 by $6,604,000.

Valuation of returnable bottles and cases is based on periodic physical inventories of those in-plant and on estimates of those in-trade. In-plant and estimated in-trade breakage is charged to cost of sales. Returnable bottles and cases are adjusted to deposit value within one year of acquisition. In foreign operations, returnable bottles and cases and the related customer deposits are translated into U.S. dollars at current rates of exchange.

Goodwill. The excess of cost over net tangible assets of companies acquired prior to November 1, 1970 (approximately $56,000,000), is not amortized unless there is an impairment of value. The remaining $85,000,000 is amortized over appropriate periods not exceeding 40 years.

Marketing Costs. Costs of advertising and other marketing and promotional programs are charged to expense during the year, generally in relation to sales, and, except for materials in inventory and prepayments, are fully expensed by the end of the year in which the cost is incurred.

Income Taxes. Deferred income taxes arise from timing differences between financial and tax reporting, principally for depreciation. Benefits from investment tax credits are amortized over the estimated useful lives of the related assets.

Additional taxes which would result from dividend distributions by foreign subsidiaries to the U.S. parent are provided to the extent dividends are anticipated. All other undistributed earnings of subsidiaries operating outside the U.S. have been reinvested indefinitely in foreign operations. Accordingly, no provision has been made for additional taxes, not material in amount, that might be payable with respect to such earnings in the event of remittance.

Fiscal Year. PepsiCo's fiscal year ends on the last Saturday in December. Fiscal year 1977 ended on December 31, 1977 and comprised fifty-three weeks; fiscal year 1976 ended on December 25, 1976 and comprised fifty-two weeks.

Net Income Per Share. Net income per share is computed by dividing consolidated net income by the average number of common shares and common share equivalents (stock options and warrants) outstanding during each year. The conversion of all convertible debentures and notes would not result in a material dilution.

Note 2/Merger with Pizza Hut, Inc.:

In November, 1977, a wholly-owned subsidiary of PepsiCo merged with Pizza Hut, Inc. Under the merger agreement, PepsiCo issued 13,066,000 shares of its capital stock for the outstanding Pizza Hut common stock. The transaction was accounted for as a pooling of interests, and PepsiCo's 1976 consolidated financial statements have been restated to include Pizza Hut, thereby increasing retained earnings of PepsiCo at December 27, 1975 by $37,454,000.

Revenues and net income in 1977 of Pizza Hut prior to combination (January 1 to September 30) were $282,741,000 and $17,682,000, respectively.

In order to conform with PepsiCo's accounting policies, Pizza Hut's net income has been reduced by. $2,050,000 for the year ended December 31, 1977 and $1,021,000 for the year ended December 25, 1976 reflecting the effect of changing to the deferral method of accounting for investment tax credits. Due to the dilutive effect of Pizza Hut's convertible debentures (which were converted during 1976), PepsiCo's restated fully diluted earnings per share were $1.74 for the year ended December 25, 1976.

Note 3/Discontinued leasing operations:

In 1976 PepsiCo completed the divestiture of its major leasing operations. PepsiCo's truck rental operations were sold in the first quarter of 1976 for a loss of $3,765,000, net of $693,000 of related tax benefits. All other operations included in the Leasing Division were sold at their approximate carrying values.

Note 4/Operations in different industries and geographical areas:

Information related to revenues and operating profit for 1977 and 1976 for PepsiCo's lines of business is presented on page 34. Additional information is provided below pursuant to Statement of Financial Accounting Standards No. 14.

Lines of Business (in millions)

	Identifiable Assets		Depreciation and Amortization Expense		Capital Expenditures	
	1977	1976	1977	1976	1977	1976
	$	$	$	$	$	$
Beverage	566.9	475.9	28.0	24.6	69.4	39.3
Food products	410.0	358.6	24.9	22.1	57.4	43.1
Food service	258.7	214.0	15.0	10.9	79.9	49.6
Transportation	264.5	231.9	15.0	12.5	38.5	33.7
Sporting goods	253.2	235.1	3.7	3.2	10.7	10.2
Corporate	294.0(1)	272.2(1)	3.3	3.0	3.7	2.3
Total	2,047.3	1,787.7	89.9	76.3	259.6	178.2
Foreign portion	535.5(2)	447.9(2)	17.9	14.9	47.1	30.2

(1) Corporate assets are principally marketable securities and administrative office buildings.

(2) PepsiCo's investment in foreign subsidiaries and branches outside the U.S. was $284.8 and $271.3 in 1977 and 1976, respectively.

Foreign exchange losses in 1977 and 1976 were $7,800,000 and $4,300,000, respectively, before related tax benefits.

Note 5/Inventories:

Inventories at December 31, 1977 and December 25, 1976 are summarized as follows:

	1977	1976
	(in thousands)	
Finished goods	$122,693	$113,214
Raw materials, supplies and in-process	178,771	146,269
Equipment held for resale	12,850	8,802
	$314,314	$268,285

Note 6/Long-term debt:

At December 31, 1977 and December 25, 1976, long-term debt (less current installments of $3,700,000 due in 1978, and $3,386,000 due in 1977) consisted of:

	1977	1976
	(in thousands)	
8⅝% notes due 1981	$ 75,000	$ 75,000
8¼% notes due 1985	100,000	100,000
6¼% 60,000,000 Swiss franc loan (Sw. Fr. 5,000,000 due annually from 1984 to 1987, with balance due in 1988)	30,000	24,510
4¾% convertible subordinated debentures ($2,500,000 due annually from 1982 to 1995, with balance due in 1996)	49,955	49,968
10⅜% promissory notes due semiannually from 1979 to 1990	16,000	16,000
Other	40,754	32,675
Total long-term debt	$311,709	$298,153

The amounts of long-term debt maturing after 1978 are as follows: 1979, $5,537,000; 1980, $8,228,000; 1981, $78,527,000; 1982, $4,735,000; and subsequently, $214,682,000.

The debt agreements to which PepsiCo is a party include various restrictions, none of which is currently significant to PepsiCo.

Note 7/Capital stock and capital in excess of par value:

In May 1977, PepsiCo shareholders approved a three-for-one split of its capital stock and concurrently approved an increase in the number of shares authorized to 100,000,000 and a change in par value to 5¢ per share from 16⅔¢ per share. These changes have been reflected in the 1977 and 1976 financial statements.

The changes in capital stock and capital in excess of par value are summarized below:

	Capital Stock Shares	Capital Stock Amount	Capital in Excess of Par value
		(dollars in thousands)	
Balance as previously reported—December 27, 1975	24,360,044	$4,060	$102,483
Effect of three-for-one stock split and change in par value	48,720,088	(406)	406
Shares issued in pooling of interests with Pizza Hut	10,963,930	548	18,924
Balance as restated—December 27, 1975	84,044,062	4,202	121,813
Conversion of debentures and notes	2,195,575	110	29,933
Exercise of stock options	286,942	14	4,638
Balance as restated—December 25, 1976	86,526,579	4,326	156,384
Conversion of debentures and notes	15,168	1	177
Exercise of stock options and warrants	317,711	16	4,778
Balance at December 31, 1977	86,859,458	$4,343	$161,339

Shares reserved at December 31, 1977 were as follows:

Stock option plans	3,131,411
Convertible subordinated debentures and notes (principally $21.17 per share)	2,367,438
Performance Share Plan	1,472,127
Warrants previously issued in connection with Pizza Hut debt (at $3.98 per share)	162,750
	7,133,726

At December 31, 1977, options were outstanding on 1,655,224 shares (of which 670,639 were then exercisable), including 319,437 shares representing options assumed pursuant to the terms of the Pizza Hut merger agreement (see Note 2), having an aggregate option price of $35,411,000. The balance of 1,476,187 shares reserved is available for future grants under PepsiCo's 1969 and 1975 Plans. In 1977, options for 264,857 shares were exercised having an aggregate option price of $4,352,000; options were granted for 182,378 shares having an aggregate option price of $3,456,000; and options for 227,015 shares were cancelled.

Under the 1972 Performance Share Plan for key executive employees, as amended, the Compensation Committee of the Board of Directors may award up to 1,950,000 performance share units, each unit being limited to the market value of a share of PepsiCo capital stock on date of grant. A participant's award is forfeited unless he remains continuously in the employ of PepsiCo during the award period, except in the case of death, disability, or early retirement at the request of PepsiCo. Units are not earned or paid unless PepsiCo achieves stated cumulative growth rates in net income per share over the four-year period following the award.

Payments may be made in cash, or in capital stock, or combination thereof, as the Committee decides. By January 1978, 477,873 units had been earned by participants under the 1972 and 1974 awards. During 1976, additional units were awarded of which 384,351 units were outstanding at December 31, 1977. The cost of the awards made under the Plan is being charged to income ($3,577,000 in 1977 and $4,305,000 in 1976) over the applicable four-year period. Participants may elect in advance to defer receipt of payment of awards.

Note 8/Leases and commitments:

PepsiCo and its subsidiaries have commitments for rental of restaurant buildings, office space, plant and warehouse facilities, transportation equipment and other personal property under capital leases and also under operating leases which are noncancellable but do not qualify as capital leases as defined in Statement of Financial Accounting Standards No. 13. Lease commitments on capital and operating leases expire at various dates to 2034 and 2015, respectively. Following is an analysis of leased property under capital leases by major classes at December 31, 1977 and December 25, 1976.

	1977	1976
	(in thousands)	
Buildings	$140,714	$125,888
Machinery and equipment	8,214	6,362
	148,928	132,250
Less accumulated amortization	44,805	38,156
	$104,123	$ 94,094

Following is a schedule by years of future minimum lease payments under all noncancellable leases.

	Noncancellable Leases Capital	Operating
	(in thousands)	
1978	$ 20,376	$ 21,239
1979	19,339	18,548
1980	18,255	16,661
1981	17,514	15,338
1982	16,739	14,666
Later years	174,250	113,942
Total minimum lease payments	$266,473	$200,394

The present value of net mimimum lease payments for capital leases amounts to $121,555,000 after deducting $9,008,000 for estimated executory costs (taxes, maintenance and insurance) and $135,910,000 representing imputed interest. Total rental expense for all operating leases for years ended December 31, 1977 and December 25, 1976 was $21,932,000 and $17,016,000, respectively. Contingent lease payments on restaurant buildings are normally based on a percentage of sales ranging from 1% to 3%.

At December 31, 1977 PepsiCo and its subsidiaries were contingently liable under guarantees aggregating $34,000,000.

Note 9/Income taxes:

U.S. and foreign income taxes have been provided at less than the statutory U.S. federal rate of 48% since unremitted earnings of foreign operations are subject to a lower aggregate tax rate. This is principally because a substantial portion of the earnings of a U.S. subsidiary operating in Puerto Rico (which have been invested in marketable securities) are not taxable.

Note 10/Pensions:

PepsiCo and its subsidiaries have several non-contributory pension plans covering substantially all domestic employees (mostly non-union) and certain of its employees outside the U.S. PepsiCo's policy is to accrue and fund current cost and interest, as well as amortization of prior service cost over 30 years. The excess of vested benefits over fund assets of two of the plans was approximately $2,200,000. For all plans combined, assets exceeded vested benefits. Pension expense of all plans was approximately $24,300,000 in 1977 and $21,500,000 in 1976.

Note 11/Litigation:

In 1971, the Federal Trade Commission (FTC) issued complaints against eight soft drink manufacturers, including PepsiCo and its principal competitors, alleging that exclusive territorial restrictions imposed upon its soft drink bottlers in the United States unreasonably restrained trade. In October, 1975, the FTC Administrative Law Judge dismissed the complaint against PepsiCo, and counsel for the FTC appealed this decision to the FTC. Management and its counsel cannot evaluate the future financial or business effects, if

any, on its domestic concentrate and syrup manufacturing or soft drink bottling business should the dismissal be reversed by the FTC and that reversal subsequently affirmed by the courts, thereby resulting in a final determination that such exclusive territorial restrictions are illegal.

PepsiCo and its subsidiaries are involved in various other matters in litigation, but believe that any such litigation will not have a material effect on the consolidated financial statements.

PepsiCo intends a vigorous defense of these matters.

Note 12/Quarterly financial data (unaudited):

Summarized quarterly financial data (in thousands of dollars except for per share amounts) for 1977 and 1976 are as follows:

	1977 Quarters Ended				
	March 19 (12 Weeks)	June 11 (12 Weeks)	Sept. 3 (12 Weeks)	Dec. 31 (17 Weeks)	Total
Net sales and other operating revenues	$677,794	$832,145	$909,627	$1,126,148	$3,545,714
Gross profit	327,925	400,129	438,653	532,571	1,699,278
Net income	31,390	49,261	57,186	49,502	187,339
Net income per share	.36	.56	.66	.57	2.15

	1976 Quarters Ended				
	March 20 (12 Weeks)	June 12 (12 Weeks)	Sept. 4 (12 Weeks)	Dec. 25 (16 Weeks)	Total
Net sales and other operating revenues	$603,106	$730,865	$779,449	$917,192	$3,030,612
Gross profit	281,077	348,018	365,051	424,962	1,419,108
Net income	24,008	40,646	47,229	41,965	153,848
Net income per share	.29	.48	.55	.48	1.80

As a result of the merger of PepsiCo and Pizza Hut (see Note 2) and the inclusion in the financial statements of assets qualifying as capital leases (see Note 1), revenues, net income, and net income per share, previously reported were adjusted as follows (in thousands of dollars except for per share amounts):

	Adjustments to Quarters Ended In				
	March	June	Sept.	Dec.	Total
Net sales and other operating revenues					
Pizza Hut—1977	$80,000	$93,686	$109,055	$113,482	$396,223
—1976	65,738	73,838	81,864	81,717	303,157
Net income					
Pizza Hut—1977	4,241	5,886	7,555	7,141	24,823
—1976	3,359	4,950	5,457	5,402	19,168
Capital leases—1977	(302)	(303)	(302)	(303)	(1,210)
—1976	(338)	(338)	(338)	(339)	(1,353)
Net income per share					
Pizza Hut—1977	(.01)	(.02)	(.01)	(.01)	(.05)
—1976	—	(.01)	(.02)	(.01)	(.04)
Capital leases—1977	—	—	—	(.01)	(.01)
—1976	—	(.01)	—	(.01)	(.02)

See Note 3 for effect of disposal of discontinued leasing operations in 1976.

Note 13/Replacement cost information (unaudited):

Pursuant to the requirements of the Securities and Exchange Commission, PepsiCo has made certain estimates of the replacement cost of its entire productive capacity and inventories. The computations were based on the hypothetical assumption that PepsiCo would replace buildings and machinery and equipment (including those represented by capital leases) at the end of the year using the latest proven technology, without regard to the availability or cost of funds for such replacement. No attempt was made to estimate the cost savings which might be expected from increased operating efficiencies of new

facilities. Because the estimating procedures require the making of numerous subjective decisions, PepsiCo cannot warrant the accuracy of the estimates contained herein.

The computations indicate that the estimated replacement cost of buildings and machinery and equipment as of December 31, 1977 and December 25, 1976 would have been approximately 55% and 52%, respectively, above original cost when acquired. The estimated replacement cost does not represent amounts for which such facilities could be sold, nor should compliance with this requirement be interpreted to indicate that PepsiCo actually plans to sell or replace the assets at this time, or in the manner or at the cost assumed in this estimate. Depreciation expense charged to cost of sales, marketing, administrative and other expenses totaled $87,000,000 for 1977 and $74,000,000 for 1976 in the historical cost statements. Depreciation expense on assets at replacement cost would have approximated $150,000,000 and $130,000,000 for 1977 and 1976, respectively. The computed estimated replacement cost of inventory was not materially greater than the reported historical amounts (see supplementary information included in Form 10-K for replacement cost details).

Note 14/Merger with Taco Bell:

In February 1978, PepsiCo and Taco Bell reached an agreement providing for the merger of Taco Bell and a subsidiary of PepsiCo. Under the agreement PepsiCo will issue shares of its capital stock in the ratio of 1.43 shares for each outstanding share of Taco Bell common stock or a total of approximately 4,900,000 shares. The transaction will be accounted for as a pooling of interests. Taco Bell reported net income of $8,450,000 for the year ended February 28, 1977.

Report of Certified Public Accountants

Board of Directors and Shareholders
PepsiCo, Inc.

We have examined the accompanying consolidated balance sheet of PepsiCo, Inc. and subsidiaries at December 31, 1977 and December 25, 1976, and the related consolidated statements of income and retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of PepsiCo, Inc. and subsidiaries at December 31, 1977 and December 25, 1976, and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period after the restatement, with which we concur, explained in Note 1.

Arthur Young & Company

277 Park Avenue
New York, N.Y.
February 21, 1978

Ten-Year Comparative Summary
PepsiCo, Inc. and Subsidiaries

		1977	1976
Summary of Operations (in thousands except per common share)	Net sales and other operating revenues	**$3,545,714**	$3,030,612
	Cost of sales and other operating revenues	**1,846,436**	1,611,504
	Marketing, administrative and other expenses	**1,343,203**	1,119,341
	Interest expense	**42,091**	41,439
	Interest income	**(23,222)**	(23,865)
		3,208,508	2,748,419
		337,206	282,193
	U.S. and foreign income taxes	**149,867**	128,345
		187,339	153,848
	Equity in net income of PepsiCo Leasing Corporation	**—**	—
	Net income	**187,339**	153,848
	Per common share	**$ 2.15**	$ 1.80
	Cash dividends	**66,287**	47,258
	Per common share	**$ .825**	$ .633
	Additions to property, plant and equipment**	**259,598**	178,725
	Depreciation and amortization**	**89,907**	76,280
	Average common shares outstanding	**87,109**	85,671
Year-End Position (in thousands except per common share)	Working capital	**415,893**	420,001
	Property, plant and equipment—net	**840,096**	679,995
	Total assets	**2,047,291**	1,787,659
	Long-term debt and capital lease obligations	**427,850**	401,677
	Shareholders' equity	**971,847**	845,823
	Per common share	**$11.19**	$ 9.78
	Common shares outstanding	**86,859**	86,527
Statistics and Ratios	Current assets to current liabilities	**1.7 to 1**	1.9 to 1
	Return on shareholders' equity	**19.3**%	18.2%
	Return on revenues	**5.3**%	5.1%
	Long-term debt and capital lease obligations/total capitalization	**31.0**%	32.6%
	Employees	**76,000**	72,000
	Shareholders	**50,000**	46,000

This summary has been retroactively adjusted for (a) Pizza Hut acquired in a transaction accounted for as a pooling of interests, (b) the three-for-one stock split authorized in 1977, and (c) for years subsequent to 1972, the effects of early application of Statement of Financial Accounting Standards No. 13 on capital lease transactions (the effects for years prior to 1973 were not material).

*Before extraordinary items.
**Includes capital leases.

1975	1974	1973	1972	1971	1970	1969	1968
$2,657,406	$2,374,607	$1,912,971	$1,559,755	$1,368,960	$1,217,028	$1,033,189	$911,762
1,467,758	1,348,465	1,045,030	832,160	741,011	667,246	556,951	494,940
947,764	820,744	689,056	576,031	493,317	433,939	374,772	324,118
48,900	53,189	33,818	16,540	16,987	17,376	7,991	7,467
(19,589)	(16,726)	(12,291)	(8,422)	(6,825)	(4,673)	(4,286)	(3,176)
2,444,833	2,205,672	1,755,613	1,416,309	1,244,490	1,113,888	935,428	823,349
212,573	168,935	157,358	143,446	124,470	103,140	97,761	88,413
95,128	73,419	72,658	66,318	56,329	44,169	45,235	41,934
117,445	95,516	84,700	77,128	68,141	58,971	52,526	46,479
1,852	2,345	2,699	2,638	990	418	2,593	2,814
119,297	97,861	87,399	79,766	69,131	59,389	55,119*	49,293
$ 1.41	$ 1.16	$ 1.04	$ .97	$ .86	$ .76	$ .73*	$ .66
36,720	31,755	27,783	24,108	23,592	22,144	22,257	20,081
$ .500	$ .433	$ .380	$ .333	$ .333	$ .333	$ .327	$ .300
133,834	186,526	176,368	83,187	64,485	75,571	84,214	48,648
70,435	62,941	52,578	40,057	35,251	29,603	27,655	25,028
84,346	84,145	84,021	82,552	80,686	77,695	76,009	74,395
364,331	302,722	170,215	168,140	150,140	95,380	53,369	88,629
591,331	570,919	480,974	364,144	328,069	295,139	245,347	206,615
1,606,277	1,559,545	1,322,815	1,036,795	909,430	823,223	602,350	525,497
435,211	456,679	324,690	240,233	212,452	195,148	105,262	78,889
704,538	619,394	551,442	490,751	417,902	352,855	307,201	279,677
$ 8.38	$ 7.39	$ 6.59	$ 5.90	$ 5.14	$ 4.52	$ 4.02	$ 3.72
84,044	83,785	83,618	83,227	81,377	78,003	76,430	75,214
1.9 to 1	1.7 to 1	1.4 to 1	1.7 to 1	1.7 to 1	1.4 to 1	1.3 to 1	1.6 to 1
16.9%	15.8%	15.8%	16.3%	16.5%	16.8%	17.9%	17.6%
4.5%	4.1%	4.6%	5.1%	5.0%	4.9%	5.3%	5.4%
38.7%	42.9%	37.8%	33.5%	34.4%	36.3%	26.6%	23.0%
67,000	65,000	61,000	49,000	45,000	41,000	34,000	31,000
48,000	50,000	51,000	51,000	52,000	53,000	56,000	54,000

PepsiCo, Inc. Directors

Donald M. Kendall
Chairman of the Board and Chief Executive Officer, PepsiCo, Inc.

Herman W. Lay
Chairman of the Executive Committee, PepsiCo, Inc.

Andrall E. Pearson
President, PepsiCo, Inc.

Victor A. Bonomo
Executive Vice President, Operations, PepsiCo, Inc.

Frank L. Carney
Chairman of the Board and President, Pizza Hut, Inc.

William T. Coleman, Jr.
Partner, O'Melveny & Myers

Clifton C. Garvin, Jr.
Chairman of the Board and Chief Executive Officer, Exxon Corp.

T. Vincent Learson
Retired Chairman, Member of the Board of Directors, International Business Machines Corporation

Harold R. Lilley
Retired Chairman of the Board, Frito-Lay, Inc.

Herman A. Schaefer
Executive Vice President, Finance and Administration, PepsiCo, Inc.

Robert H. Stewart III
Chairman of the Board, First International Bancshares, Inc.

Peter K. Warren
President, PepsiCo International and Vice President, International Beverages, PepsiCo, Inc.

Dr. Arnold R. Weber
Provost, Carnegie-Mellon University

Caspar W. Weinberger
Member of the Board of Directors and Vice President, Bechtel Power Corporation, Bechtel Incorporated and Bechtel Corporation

Committees

Audit Commitee:
Messrs. Garvin, Learson and Stewart

Executive Committee:
Messrs. Lay, Bonomo, Garvin, Kendall, Learson, Pearson, Schaefer, Stewart and Warren

Compensation Committee:
Messrs. Stewart, Coleman, Lay, Learson and Weinberger

Officers

Donald M. Kendall
Chairman of the Board and Chief Executive Officer

Herman W. Lay
Chairman of the Executive Committee

Andrall E. Pearson
President

Victor A. Bonomo
Executive Vice President, Operations

Herman A. Schaefer
Executive Vice President, Finance and Administration

Robert J. Abernethy
Vice President, Manufacturing

Darrell Agee
Vice President, U.S. Bottling

Richard I. Ahern
Vice President, International Bottling

Richard J. Caley
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D. Wayne Calloway
Vice President, Snack Foods (U.S.)

F. Taylor Carlin
Vice President, Controller

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Gerald J. Fischer
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Harvey Luppescu
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Frank L. Peck
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Vice President, Beverage Operations (U.S.)

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Vincent M. Burke
Assistant Controller

Douglas E. Moran
Assistant Controller

Leonard Schutzman
Assistant Controller

William R. Lewis
Assistant Treasurer

Walter S. Rosenstein
Assistant Secretary

Executive Offices

PepsiCo, Inc.
Purchase, New York 10577
(914) 253-2000

Principal Divisions and Subsidiaries

Pepsi-Cola Company
Purchase, New York 10577
John Sculley, President

Frito-Lay, Inc.
Frito-Lay Tower, Exchange Park, Dallas, Texas 75235
D. Wayne Calloway, President

PepsiCo International
Purchase, New York 10577
Peter K. Warren, President

Pizza Hut, Inc.
9111 East Douglas
Wichita, Kansas 67207
Frank L. Carney, President

PepsiCo Transportation
PepsiCo Place, 525 South Main
Tulsa, Oklahoma 74103
Richard J. Caley, President

Wilson Sporting Goods Co.
2233 West Street
River Grove, Illinois 60171
Frank L. Peck, President

PepsiCo Foods International
2815 Valley View Lane
Dallas, Texas 75234
John J. Kickham, President

Pepsi-Cola Bottling Group
Purchase, New York 10577
Darrell Agee, President

United Beverages International
Purchase, New York 10577
Richard I. Ahern, President

PepsiCo Wines and Spirits International
Purchase, New York 10577
Norman Heller, President

Capital Stock

Shares of PepsiCo, Inc. Capital Stock are listed and traded on the New York and Midwest Stock Exchanges.

Form 10-K

Copies of PepsiCo's Form 10-K Report to the Securities and Exchange Commission may be obtained without charge from the Director of Corporate Communications, PepsiCo, Inc., Purchase, N.Y. 10577

Auditors
Arthur Young & Company
277 Park Avenue
New York, New York 10017

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Morgan Guaranty Trust Company of New York
30 West Broadway
New York, New York 10015
(212) 483-2323

First National Bank in Dallas
P.O. Box 6031, Dallas, Texas 75283
(214) 744-8464

Dividend Reinvestment Agent
Citibank, N.A.
111 Wall Street
New York, New York 10015
(212) 558-7409

Annual Meeting
The Annual Meeting of stockholders will be held at the offices of the Corporation, Purchase, New York, at 10:00 a.m. (E.D.T.) Wednesday, May 3, 1978. Proxies for the meeting will be solicited by management in a separate Proxy Statement. This report is not a part of such proxy solicitation and is not to be used as such.

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